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PREFACE

This publication is one of a series prepared and distributed by the Legal Assistance Branch of the Administrative and Civil Law Department of The Judge Advocate General's School, U.S. Army (TJAGSA) to assist legal assistance attorneys in the delivery of legal assistance. The information contained herein is as current as possible as of the date of publication. The law changes, however, much more rapidly than this publication can be updated and distributed. For this reason, use this publication only as a guide and not as final authority on any specific law or regulation. Where appropriate, legal assistance attorneys must consult more regularly updated references before rendering legal advice.

The series contains summaries of the law, guidance, and sample documents for handling common problems. The sample documents are guides only. Legal assistance attorneys should ensure that the samples are adapted to local circumstances and are consistent with current format provisions in Army Reg. 25-50 prior to reproduction and use.

While forms can save time for both attorneys and clerk-typists, indiscriminate use of such forms is inherently dangerous. Standard form language may not be fully appropriate for the particular client's situation. Also, the use of a form detracts from the personalized, individual service attorneys strive to give their clients. Nonetheless, the careful, selective use and editing of forms can enhance an attorney's service to clients by reducing document-drafting time and helping remind the attorney of important requirements in drafting legal documents.

The series is part of the continuing effort to improve and expand the resources available to legal assistance practitioners. As you use this publication, if you have any recommendations for improvement, please send your comments and suggestions to The Judge Advocate General's School, ATTN: JAGS-ADA-LA, Charlottesville, Virginia 22903-1781.

Legal assistance attorneys are encouraged to maintain this publication in a three-ring binder until a replacement is issued. In future years, specific page changes may be published instead of reprinting the entire publication.

Each year, the Legal Assistance Branch receives many requests for its publications. Because of limited budgetary and personnel resources, however, additional outside distribution of these materials in printed format is not possible.

There are, however, several ways to obtain many of these publications. First, the Defense Technical Information Center (DTIC) makes some of these publications available to government users. Practitioners may request the necessary information and forms to become registered as a user from: Defense Technical Information Center, 8725 John J. Kingman Road, Suite 0944, Fort Belvoir, Virginia 22060-6218, telephone (703) 767-9087 or DSN 427-9087.

Second, this and many other word processing documents are uploaded on to the Legal Automation Army-Wide Systems Bulletin Board System (LAAWS BBS). Some of these are now in or being converted to Microsoft Word version 6.0 format. Others are in ASCII and WordPerfect. Users can sign on the LAAWS BBS by dialing (703) 806-5772 with the following telecommunications configuration: 2400 - 19,200 bps; parity-none; 8 bits; 1 stop bit; full duplex; Xon/Xoff supported; VT100 terminal emulation. After signing on to the LAAWS BBS, the desired publication can be downloaded to the user's computer. Consult THE ARMY LAWYER for current information on new publications available through the LAAWS BBS. Questions concerning LAAWS BBS should be directed to the OTJAG LAAWS Office at (703) 805-2922.

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The following Legal Assistance Branch publications are currently available in "zipped" format:

Number	Title
JA 260	Soldiers' & Sailors' Civil Relief Act
JA 261	Legal Assistance Real Property Guide
JA 262	Legal Assistance Wills Guide
JA 263	Legal Assistance Family Law Guide
JA 265	Legal Assistance Consumer Law Guide
JA 267	Uniformed Services Worldwide Legal Assistance Office Directory
JA 269	Legal Assistance Federal Income Tax Information Series
JA 271	Legal Assistance Office Administration Guide
JA 272	Legal Assistance Deployment Guide
JA 274	Uniformed Services Former Spouses' Protection Act - Outline and References
JA 275	Model Tax Assistance Program
JA 276	Preventive Law Series

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This publication does not promulgate Department of the Army policy and does not necessarily reflect the views of The Judge Advocate General or any government agency.

The Legal Assistance Branch expresses deep appreciation to LTC Urs Gsteiger, USAR, who conducted the vast majority of the substantive review of this publication.

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CHAPTER 1

RESIDENTIAL REAL ESTATE SALES

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I. INTRODUCTION

People buy homes for a number of reasons. In addition to serving as lodging, homes are purchased as a place to raise children, as investments, for tax-savings, and as hedges against inflation. Home ownership satisfies dreams and serves as a form of identity and sense of belonging. It is also a means of lifestyle and prestige. Whatever the reasons, the purchase of a home is a complex and expensive matter. For the uninitiated, it can also be an emotional, if not traumatic, experience. Frequently, buyers, and even sellers, are confused and bewildered by the complexities of a real estate transaction. Uninformed decisions are made. In the end, costly mistakes may occur that might have been avoided or minimized.

This chapter is a guide to the basics of a residential real estate transaction. It is not intended to serve as a definitive treatment of the laws and procedures involved in the purchase or sale of a home. It is designed to acquaint the new home buyer or seller with the mechanics of a transaction, the various ramifications, and the pitfalls to avoid. Accordingly, the use of legalistic and technical language has been minimized in order to make the text both readable and informative. The chapter is also designed to assist legal advisers who are not specialists, but who need to be aware of recent legal developments.

In the past decade, substantial change has occurred in real estate law and practices. Court decisions still remain the basic source of real estate law, but state and federal statutes are rapidly supplanting much of decisional law. The local character of real estate transactions that previously prevailed is diminishing by virtue of the uniformity resulting from Federal Housing Administration (FHA), Veteran's Administration (VA), and Federal National Mortgage Association (FNMA) requirements and such federal laws as the Real Estate Settlement Procedures Act (RESPA). Additional change has occurred by the tide of consumer protection legislation, environmental laws, and land use controls. This article addresses a number of these changes.

Perhaps the greatest change has occurred with respect to the financing of home purchases. As a result of persistent high inflation and the volatile money market of the 1980's, the traditional fixed-rate, long-term, assumable mortgage is a relic of the past. While interest rates have stabilized in the 1990's and fixed rate mortgages have made a comeback, they are no longer assumable and buyers will quickly resort to alternative financing vehicles if interest rates rise. The various alternative mortgage instruments (variable interest rates, short-term maturities, graduated payments, etc.) are fast becoming common and will be the dominant alternate financing instruments of the future. In the meantime, the so-called creative financing techniques, such as wrap-around mortgages, seller financing, and land contracts, also gained wider use as a means of sidestepping high interest rates. In today's market, it is more important than ever that a buyer and seller fully understand the various methods and alternatives of home financing. A major portion of this chapter is devoted to this subject.

II. PROFESSIONAL ASSISTANCE IN BUYING OR SELLING A HOME.

A. Legal Assistance Attorneys.

For soldiers, the legal assistance attorney can provide general advice and assistance in the purchase or sale of a home. Eligible personnel should avail themselves of this assistance, particularly if they are unfamiliar with real estate transactions. This assistance should include reviewing contracts for sale and listing agreements, as well as general advice concerning closing documents and financing instruments. Normally, legal assistance attorneys will not be able to represent individuals during closing or participate directly in transactions. In order to be adequately represented in all phases of a real estate transaction, military personnel should seriously consider retaining a private attorney engaged in real estate practice in the community.

B. Private Attorneys.

While it is not absolutely necessary for an individual to retain his own attorney, it is nevertheless highly recommended that he do so, either for the entire transaction or at least to review all documents. The most valuable service an attorney can render to his client in a real estate transaction is before the first paper is signed. In the case of a seller who intends to deal through a real estate agent, before any agreement is made with the agent, the seller's attorney should be consulted. He may be able to assist in eliminating any undesirable terms from a proposed listing or in assuring that the seller has reasonable provisions for terminating the listing. For the buyer or seller, an attorney's suggestions concerning proposed sales contract terms can be invaluable. One is not going to be able to close a real estate transaction, either as buyer or seller, without incurring some legal fees directly or indirectly. The amount of such fees should not increase significantly when one retains and works with an attorney from the very beginning of the transaction. The trouble and money the attorney can save by getting involved from the start will probably offset any increase in the total cost of the transaction.

One should come to an understanding with the attorney concerning fees at the first meeting. The charges may be based on the number of hours the attorney works on the matter, or may be based on a fixed rate for certain specified services. Whether or not one works through an agent, all documents to be signed should be reviewed, or drafted, by an attorney. When dealing through an agent, one most likely will be working with the agent's forms, which should be reviewed by the attorney. When not dealing through an agent, it is especially important that an attorney be consulted either to review or draft all documents. Standard, model forms provided by a realtor should not be used without the advice and assistance of counsel.

It is important to select an attorney who is well versed in real estate transactions. The purchaser should not assume that another party's (seller, builder, lender, title company, etc.) attorney will represent the purchaser's interests. The local bar association lawyer referral service can assist in locating an attorney. Legal assistance attorneys can also help in finding an attorney.

C. Real Estate Agents.

Although many homes are bought and sold without the services of a real estate agent, the vast majority of real estate transactions are consummated through agents. All states have laws governing the licensing of real estate brokers and agents, most of which impose various educational and testing requirements. Real estate agents are employed by brokers. In most instances, home buyers and sellers deal only with agents. (For purposes of this chapter, the terms "agent and broker" are used synonymously.)

The basic role of a real estate agent is to bring a willing buyer to the seller and assist in the negotiation and conclusion of the transaction. Most agents work on a commission basis. Frequently, agents may work on a large number of potential transactions before one is consummated. At common law, a realtor earns a commission when he finds a buyer who is ready and willing to purchase the property on the terms of the listing agreement. This rule can be altered by the listing agreement or by statute to require an actual sale before the commission is earned.

The prevalent practice is for the seller to pay the agent's commission. (This is provided for in the listing agreement, and it should be specifically stated in the sales contract.) In such cases, it should be kept in mind that the agent is the seller's agent; thus, he represents the seller in the transaction. If a buyer wants independent advice, he should consider retaining a buyer's agent, who is paid by the buyer and, therefore, owes his duty only to the buyer. Many states now recognize both seller's agents and buyer's agents and require agents to disclose, in writing, to whom they owe their legal and fiduciary duty.

An agent can assist in making a prospective buyer's house hunting more productive by locating properties and arranging visits to homes on the market. An agent's search is facilitated in metropolitan areas where the local real estate industry has a computerized Multiple Listing Service (MLS) operated by the local real estate board. Real estate firms who are members of the MLS place their listings (homes for sale), together with all pertinent information concerning the homes, in the MLS computer. A prospective buyer provides to the real estate agent the various specifications he needs or desires, such as price, number of bedrooms, location, and style. The agent enters these requirements into a computer and receives a list of comparable properties. A multiple listing service is an effective means of quickly narrowing down the number of houses in a large market that would be suitable for inspection. It also helps assure that no suitable home has been overlooked.

From the buyer's point of view, it should be kept in mind that a purchase direct from an owner does not necessarily mean that the buyer will have purchased at a price lower than he would have had to pay through an agent.

From the seller's point of view, an agent's knowledge of the market and his ability to match his many prospects' needs to the seller's property, to arrange financing which will make the property marketable, to follow up prospects effectively, and to close a sale, afford the seller considerable assurance that he will receive the best price for his house in a minimum period of time.

Whether a buyer or seller, one should select an agent who enjoys a good reputation, is active in the area, and sells homes in the appropriate price range. In retaining an agent, one should consider an agent who is a realtor. The term "realtor" is a copyrighted word which can be used only by agents who are members of a local real estate board that is a member of the National Association of Real Estate Boards. These boards impose a code of ethics on members and are generally recognized as authoritative control agencies in the real estate field.

D. Appraisers.

In buying or selling a home, particularly in the absence of a real estate agent, an individual should consider obtaining an appraisal of the property from a professional appraiser. A seller may benefit from such an appraisal by being reasonably assured that he has not undervalued or overpriced his home. The buyer may also benefit from an appraisal by the assurance it gives him that he is paying a fair price. Appraising, however, is not an exact science; and any two appraisers can differ to some degree on the value of a certain property.

If one desires the services of an independent appraiser, they are usually listed in the Yellow Pages of the telephone directory under Real Estate Appraisers. In selecting an appraiser, one may wish to retain an appraiser whose advertisement indicates that he is a member of the American Institute of Real Estate Appraisers or is a Senior Residential Appraiser or Senior Real Estate Appraiser as designated by the Society of Real Estate Appraisers. To acquire these designations, the appraiser must meet certain examination and experience requirements established by the associations, and must adhere to their code of ethics.

If the proposed sale contemplates that the buyer is to obtain new financing, an appraisal by the new lender (or by the FHA or VA) is a necessity. In such cases, the lender (or FHA or VA) will select the appraiser. In most cases, the buyer and seller can usually rely on that appraisal as an acceptable substitute for an independent appraisal. As a caveat, in some jurisdictions in the absence of fraud, there may be no duty running from an appraiser or engineer retained by the lender to the persons applying for financing. Similarly, if the appraiser or home inspector has been retained by a government agency, any error may be construed as a misrepresentation which is not actionable against the United States under the Federal Tort Claims Act.

E. Home Inspection Report.

In determining whether to purchase a particular home, the buyer should consider retaining a professional housing engineer to inspect the home as to its structural soundness. Such inspections cover a number of items and generally include an assessment of the foundation, roof, drainage, plumbing, electrical system, heating and cooling systems, and major appliances. Based on the inspection report, a buyer could then better assess the value of the property and negotiate with the seller as to needed repairs. (Professional home inspectors are usually listed in the Yellow Pages under Building or Home Inspection Service.) Unfortunately, there is little regulation in this field and almost anyone can call himself a home inspector.

F. Lending Institutions.

A seller can facilitate the sale of his home by determining what financing a qualified buyer may be able to obtain on the home. By checking with a few lenders, including FHA and VA, the seller will then be in a position to give his prospective buyers an indication as to available financing. If a homeowner has listed his property with a real estate agent, the agent should determine available financing. The agent's ability to assist in securing the best available financing is, in fact, one of the most important contributions he can make in selling a home. Prospective purchasers should not assume that all banks or lending institutions will offer the same terms.

III. FEDERAL LAWS RELATING TO RESIDENTIAL PURCHASES.

State law generally governs the purchase and sale of a home. There are, however, a number of federal laws that affect various aspects of such real estate transactions. Some of the more important federal laws are briefly described below. These are fairly technical laws and can only be described here in general terms. For additional details, readers should contact the information sources provided herein.

A. Federal Fair Housing Laws.

There are two major federal laws that protect home buyers from certain discriminatory practices. The first is the Civil Rights Act of 1866, 42 U.S.C. § 1982, which provides that "All citizens of the United States shall have the same right in every State and Territory, as is enjoyed by white persons thereof, to inherit, purchase, lease, sell, hold and convey real and personal property." In Jones v. Mayer, 392 U.S. 409 (1968), the Supreme Court held that this Act bars all racial discrimination, private as well as public, against U.S. citizens in the sale or rental of property. A victim of such racial discrimination may sue for damages and equitable relief, such as an order compelling sale of the property or an order prohibiting sale to another.

The second major legislation is Title VII of the Civil Rights Act of 1968, as amended, 42 U.S.C § 3601 et seq., which prohibits discrimination in the sale or rental of most housing on the basis of race, color, religion, national origin, or gender. The following are prohibited activities (if they are motivated on any such basis):

- Refusing to sell or rent to, or deal or negotiate with any person.
- Discriminating in terms or conditions for buying or renting housing.
- Discriminating by advertising that housing is available to persons of a certain race, color, religion, national origin, or sex.
- Denying that housing is available for inspection, sale, or rent when it is really available.
- "Blockbusting" for profit, i.e., persuading owners to sell or rent housing by telling them that minority groups are moving into the neighborhood.

- Denying or making different terms or conditions for home loans by commercial lenders such as banks, savings and loan associations, and insurance companies.
- Denying to anyone the use of or participation in any real estate services, such as brokers, organizations, multiple listing services, or other facilities relating to the selling or renting of housing.

However, unlike the 1866 Civil Rights Act (which applies only to racial discrimination), the proscriptions of Title VII do not apply to the following:

- The sale or rental of single family homes owned by a private individual owner of three or fewer such single family homes, provided that (i) a broker is not used, (ii) discriminatory advertising is not used, and (iii) the owner has sold no more than one such home (other than his personal residence) during any two-year period.
- The rentals of rooms or units in owner-occupied 2- to 4-family dwellings, provided that discriminatory advertising is not used.
- Limiting the sale, rental, or occupancy of dwellings that a religious organization owns or operates for other than a commercial purpose to persons of the same religion, if membership in that religion is not restricted on account of race, color, or national origin.
- Limiting to its own members the rental or occupancy of lodgings which a private club owns or operates for other than a commercial purpose.

The Act provides for three enforcement remedies. First, the Department of Housing and Urban Development (HUD) can initiate conciliatory efforts upon receipt of a complaint filed by a grievant. If a state or local law provides rights and remedies substantially equivalent to Title VII, the complaint may be referred to the appropriate state or local agency. HUD may also refer the complaint to the U.S. Attorney General. Second, the complainant has a right of private civil action. A court may grant an injunction and award actual damages and punitive damages up to $1,000. Third, the U.S. Attorney General may file suit in federal court if there is reason to believe that a pattern of discrimination exists or that a group of people have been denied rights protected under Title VII.

B. Equal Credit Opportunity Act.

Enacted in 1974 as Title VII of the Consumer Credit Protection Act, 15 U.S.C. § 1691 et seq., and amended in 1976, the Equal Credit Opportunity Act prohibits a lender from discriminating against an applicant for a mortgage or home improvement loan on the basis of (i) race, (ii) color, (iii) religion, (iv) national origin, (v) sex, (vi) marital status, (vii) age, (viii) receipt of income from public assistance programs, or (ix) the good faith exercise of rights under the Consumer Credit Protection Act. Implementing regulations (Regulation B, 12 C.F.R. § 202) have been issued by the Board of Governors of the Federal Reserve System. The Act and the regulations are administratively enforced by the federal agency that regulates the particular lender (e.g., the Comptroller of the Currency in the case of national banks and the Federal Home Loan Bank Board in the case of federal savings and loan associations). In addition, individuals

who have been discriminated against in violation of the Act have a private right of action for actual damages and punitive damages up to $10, 000.

The Act does not assure that an applicant will receive a loan. Lenders are entitled to appraise the credit worthiness of applicants. But the Act does restrict a lender's inquiries and appraisal to those factors that essentially determine an applicant's credit worthiness (e.g., income, assets, expenses, debts, credit record, and reliability).

The following is a summary of some of the major provisions of Regulation B with respect to mortgage financing:

- Lenders are required to notify an applicant whether the loan is approved within 30 days after the application and any necessary appraisals, credit checks, or government approvals have been completed. If a loan is denied (or loan terms substantially altered), the applicant must be advised of the reasons for the denial, his rights under the Equal Credit Opportunity Act, and the name and address of the federal agency responsible for enforcement.
- Generally, lenders may not discourage individuals from applying for mortgage loans, nor may they require information that is not directly related to evaluating the credit worthiness of an applicant.
- Lenders are required to ask mortgage loan applicants for information regarding their age, race, gender, national origin, and marital status which is to be used solely for federal enforcement purposes. Applicants, however, have the right to refuse to provide such information.
- Lenders may not request information about birth control practices, childbearing plans, or generally about the applicant's spouse; but they may inquire about the number and age of the applicant's dependents.
- Lenders must consider such income sources as alimony, child support, part-time employment income, and public assistance payments, when evidence is furnished by an applicant, if they are likely to be reliable and consistent sources of income.
- Lenders may not require a cosigner if the applicant is credit worthy, although a spouse's or co-owner's signature may be required on mortgage documents.

Additional information on the Equal Credit Opportunity Act and Regulation B may be obtained from the Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

C. Federal Truth in Lending Act.

This law, enacted in 1968 as Title I of the Federal Consumer Credit Protection Act, 15 U.S.C. §§ 1601 et seq., is designed to assure a meaningful disclosure of credit terms (i.e., the cost of a loan) so that a borrower will be able to compare more readily the various credit terms available to him. The Act is a disclosure statute; it does not regulate or control loan terms, interest rates, or finance charges. The law is administered by the Board of Governors of the Federal Reserve System, which has issued implementing regulations (Regulation Z, 12 C.F.R.

Part 226). While the Act applies to all types of consumer credit, this discussion is limited to its effect on mortgage loans to finance the purchase of a home.

The Act requires mortgage lending institutions to provide prospective borrowers with a written statement which discloses the finance charges, including the annual percentage rate. The disclosed finance charge includes all items which a borrower must pay for the loan, such as loan fees, mortgage insurance premiums, discount points, service fees, and premiums for required property and life insurance if the borrower is not allowed to select his own insurer. The total dollar amount of the finance charges on first mortgage loans needs not be disclosed, except that the annual percentage rate must be provided. Appraisal and credit report fees are not required to be included, nor are customary closing costs items (e.g., title insurance, preparation of documents, escrowed funds, notary fees, etc.).

A lender may be subject to both civil and criminal penalties for failure to comply with the Truth in Lending Act. In addition, a borrower has a private right of action in which he may collect up to twice the amount of the finance charge. A borrower is not, however, relieved of the obligation to repay the loan.

D. Real Estate Settlement Procedure Act (RESPA).

Enacted in 1974 and codified at 12 U.S.C. § 2601 et seq., the RESPA is intended to provide home buyers with greater and more timely information on settlement costs. The RESPA also establishes uniform settlement procedures and proscribes certain practices. It does not, however, set or regulate the costs of settlement services. Regulations promulgated by the Department of Housing and Urban Development (HUD), 24 C.F.R., Part 3500, implement the Act. The RESPA applies to all residential real estate transactions (including condominiums and cooperatives) in which "federally related mortgage loans" are involved. This covers almost all home mortgage loans made by institutional lenders. There are some exemptions, notably loan assumptions, second mortgages, and refinancing. The principal provisions of the RESPA are as follows:

- Within three days of making a written loan application, the lender must provide the loan applicant with a copy of HUD's "Special Information Booklet." This booklet describes the costs and services related to the settlement process.
- Also within three days, a lender is required to give the loan applicant a good faith estimate of settlement costs.
- A uniform settlement form (Form HUD-1) prepared by HUD must be used as the settlement statement. (This statement is discussed in Part VIII).
- Payment or receipt of unearned fees or "kickback" for referrals of settlement services is prohibited. Violators are subject to criminal penalties and treble damages.
- Sellers are prohibited from requiring that the buyer purchase title insurance from a particular insurance company. Violations subject sellers to treble damages.

- Lenders are prohibited from requiring escrow deposits for taxes, insurance, and other charges in excess of the amount needed to make payments, plus two months' deposits. Lenders can require additional payments to cover deficiencies.

Additional information concerning the RESPA can be obtained from the Real Estate Practices Division, Office of Neighborhoods, Voluntary Associations and Consumer Protection, Department of Housing and Urban Development, Washington, D.C. 20410.

E. Interstate Land Sales.

The Interstate Land Sales Full Disclosure Act, 15 U.S.C. § 1701 et seq., was enacted in 1968 in response to manifest abuses in the interstate sale of undeveloped land. The Act makes it unlawful for a developer to offer the sale, through the mails or other means of interstate commerce, of unimproved lots under a common promotional sales plan unless the land is registered with HUD and the purchaser is furnished a property report. The law is essentially a disclosure statute and does not affect the terms of a sale. A purchaser, however, is entitled to rescind his contract if a developer fails to comply with the Act. Violations of the Act may also subject a developer to criminal penalties. HUD's implementing regulations are set forth in 24 C.F.R., Part 1710.

To obtain additional information, contact the Office of Interstate Land Sales Registration, Department of Housing and Urban Development, Washington, D.C. 20410.

F. National Flood Insurance Program.

Under the National Flood Insurance Act of 1968, as amended, 42 U.S.C. § 4001 et seq., the Federal Insurance Administration, within the Federal Emergency Management Agency (FEMA), administers a program that provides low cost flood insurance protection for homeowners in locations that have been designated as flood areas. Such subsidized insurance is available only on homes in qualifying communities. Communities in designated flood areas qualify by participating in the National Flood Insurance Program and by adopting approved flood control measures. After a community qualifies, flood insurance may be purchased by a homeowner through insurance agents or brokers in the locality.

A prospective buyer can usually find out whether a home is located in a designated flood area, and whether the community has qualified, through his real estate agent or by checking with community officials, local insurance agents, or by calling FEMA. (FEMA's toll free number is 1-800-424-8872.)

Flood insurance is now required for the mortgage financing of homes located in flood areas of qualifying communities if the source of such financing is a VA or FHA loan or a conventional loan from a federally regulated lender.

G. Soldiers' and Sailors' Civil Relief Act.

Section 302 of this Act (50 U.S.C. App. § 532) offers certain protection to a service member with respect to foreclosure actions in the event of default on the mortgage loan. This protection applies to a service member's mortgage loan that originated prior to entry into military

service. In an action by a lender to enforce the mortgage loan because of nonpayment, the court may, on its own motion, or will, on proper application by the service member, grant the following relief (unless it believes that the ability of the service member to comply with the terms of the mortgage loan is not materially affected by reason of the military service): (i) stay the proceedings or (ii) dispose of the case in a manner that is equitable to all parties. The Act further provides that sale, foreclosure, or seizure of the property for nonpayment or breach of other terms is invalid if made during the period of military service or within three months thereafter in the absence of a written agreement between the parties or in the absence of a court order. Further details regarding rights under the Soldiers' and Sailors' Civil Relief Act may be found in DA Pamphlet 27-166, The Soldiers' and Sailors' Civil Relief Act.

H. Military Base Closings.

There are two statutory provisions designed to assist military and civilian employee homeowners at military bases ordered closed by the Department of Defense. The first, 12 U.S.C. § 1735g, provides that a "distressed mortgagor" may obtain a moratorium on mortgage payments on FHA or VA mortgaged homes in the vicinity of the closed base for periods up to two years. During the moratorium period, mortgage and tax payments are made by the homeowner's government agency. Such payments must subsequently be repaid to the agency by the homeowner over a period determined by the agency. To qualify as a "distressed mortgagor," the FHA or VA must determine that the homeowner's employment or service at the base must have terminated as a result of the base closing and that the loan is in default because of the mortgagor's inability to make payments.

The second provision, 42 U.S.C. § 3374, authorizes even broader relief. It provides that eligible persons may (1) receive a cash payment as compensation for losses sustained in a private sale in an amount not to exceed the difference between (A) 95 percent of the fair market value of their property prior to public announcement of intention to close all or part of the military base or installation and (B) the fair market value of such property at the time of sale, or (2) receive as the purchase price for their property an amount not to exceed 90 percent of prior fair market value or the amount of the outstanding mortgage. Cash payment as compensation for losses sustained in a private sale are not made in any case in which the property is encumbered by a mortgage loan guaranteed, insured, or held by a federal agency unless the loan is paid, assumed by a purchaser satisfactory to such federal agency, or otherwise fully satisfied at or prior to the time such cash payment is made.

In order to be eligible for the benefits of this section, such employees or military personnel must have been (1) assigned to or employed at the installation or activity at the time of public announcement of the closure action; (2) transferred from such installation or activity (or terminated as employees as a result of reduction-in-force) within six months prior to public announcement of the closure action; or (3) transferred from the installation or activity on an overseas tour unaccompanied by dependents within fifteen months prior to public announcement of the closure action.

Other requirements are that such personnel or employees (i) must have been the owner-occupant of the dwelling, or have vacated the owned dwelling as a result of being ordered into on-post housing; and (ii) must be required to relocate because of military transfer or acceptance

of employment beyond a normal commuting distance from such dwelling, or be unemployed, not as a matter of personal choice, and be able to demonstrate such financial hardship that they are unable to meet their mortgage payments and related expenses.

I. Relocation Costs for Civilian U.S. Employees.

Transferred civilian employees are authorized, under 5 U.S.C. § 5724a, certain assistance in the sale of their homes and the purchase of homes at their new official stations. In general, most of the expenses involved in the sale of an employee's home subject to statutory limitation (including a customary agent's commission) are reimbursable to the employee. No similar benefits are available for military personnel.

In general, to be eligible for the benefits of this law, the employee must sign an agreement to remain in the service of the government for 12 months and the transfer must not be primarily for the convenience of the employee or at his request. Sale of the old residence and purchase of the new must be within 12 months after the employee reported for duty at the new station, unless an extension of such period is approved by the head of the agency concerned or settlement is necessarily delayed because of litigation.

J. Federal Preemption of State Usury Laws.

Section 501 of the Depository Institutions Deregulation and Monetary Control Act of 1980 (12 U.S.C. §§ 1735f-7) provided for the federal preemption of any state law which limited the interest rates on home mortgage loans. States were permitted to override the preemption by enacting a law to that effect. This law was enacted to ease the severity of the mortgage credit crunches of past years. Subject to the right of states to override the exemption, this law declares inapplicable any state usury law (including discount points) with respect to first lien mortgage loans on residential property made after March 31, 1980, by essentially all institutional lenders.

IV. LISTINGS.

A. Listing Agreement.

When a seller retains the services of a real estate agent to assist in the sale of his home, he will be asked to sign a listing agreement. It is possible to have an "oral" listing, but to do so is an invitation to uncertainty, misunderstanding, and trouble. A written listing agreement is the only safe course to follow. The three basic types of listing agreements are: open, exclusive agency, and exclusive right to sell, which includes multiple listings in areas where a multiple listing service exists. (These different types of listings are discussed below.) No matter what type of listing is used, keep in mind that a listing is a contractual arrangement that establishes legal rights and obligations; and it may impose upon the seller the obligation to pay a sales commission even though the agent is not involved in the actual sale of the property.

The listing agreement will indicate the sales price (asking price) upon which the house will be placed on the market. The asking price should be close to the market value of the house. Market value is usually based on recent comparable sales of other houses in the same general

locality. The seller should decide his asking price with the assistance of his agent. The agent may provide a market analysis report.

The listing agreement will also set forth the period of the listing, generally 90 to 120 days, and the amount of the agent's commission, which is usually expressed as a fixed percent of the actual selling price. Keep in mind that the amount of the commission and the listing period are negotiable. Both the seller and the agent must agree as to the terms. Although it is understandable that a seller would like to keep the commission low and the listing period short, it should be recognized that this could adversely affect marketing of the property. Agents are not likely to expend as much time, money, and effort if the commission is small or if there is only minimal time to advertise and promote the sale of the property.

A seller should seek a commitment from his agent as to the advertising (nature, amount, and frequency) that will be devoted to the sale of the home as well as other marketing techniques (e.g., open house) that will be employed. Also, a seller should make clear at the outset what items he does not intend to include in the sale (e.g., chandeliers, draperies, carpeting, appliances, etc.).

The listing agreement establishes the agency relationship between the seller and the agent. The agent is retained to procure a buyer ready, willing, and able to buy on the terms proposed by the seller. The seller is responsible for the payment of the prescribed commission, which, in most cases, is paid at the time of settlement from the proceeds of the sale. It is possible, however, in some jurisdictions, for the seller to become obligated to pay a commission even though an actual sale never resulted, if the realtor produced a ready, willing, and able buyer during the listing period. The listing agreement can and should be drafted to require payment of a commission only upon transfer of title. Because the seller is responsible for the commission, the buyer generally need not be concerned with the listing arrangement, or type of listing, that an agent may have, unless the buyer has made a special arrangement with the agent regarding the payment of a commission.

Generally, if a buyer is led to, or becomes interested in, a house because of the efforts of an agent, that agent will be entitled to a commission if a sale occurs regardless of the type of listing. The seller and such a buyer cannot deal directly with one another and thus avoid paying a commission, even after the listing has expired. Therefore, if a seller has previously listed his property and the listing has expired (or if he has an exclusive listing but reserves the right to sell it himself), he must exercise care to ensure that he does not unknowingly become liable for payment of a commission. This could happen if a seller sold to a buyer who became interested in the house through an agent's efforts, but the purchaser buys directly from the seller shortly after the listing expires or without telling the seller that he had been shown the house by an agent. The seller can protect himself from this potential problem by providing in his listing that no commission will be paid unless prospect's names are furnished him in writing by the agent within a specified period after the house has been shown, or by having the sales contract include a suitable representation by the buyer that an agent's services were or were not involved. If the possibility of such a problem exists, one should consult an attorney before signing a sales contract.

1. Open Listing.

In an open listing, the seller offers the listing to any number of agents and, in essence, promises to pay the agreed commission to that agent who produces a buyer ready, willing, and able to buy upon the terms set forth in the listing agreement prior to the time the listing expires or the house is sold. The major drawback to an open listing is that agents will seldom devote any substantial time and money in promoting the listing because their chances of earning the commission are usually too uncertain. Conflicts can also develop over who is entitled to a commission in instances where more than one agent worked with the buyer.

2. Exclusive Listing.

The exclusive listing may be either an exclusive agency or an exclusive right to sell. Under an exclusive agency, the owner agrees that the agent shall be the only agent with whom the house shall be listed for a specified period; but the owner reserves the right of selling the property himself without being obligated to the agent for the payment of a commission.

Under the exclusive right to sell, the agent has the sole right to sell the house and is entitled to a commission even if the property is sold by another agent or by the owner himself.

3. Multiple Listing.

The multiple listing, which is the most prevalent arrangement, is a variation of the exclusive right to sell listing. The seller gives an exclusive right to sell to a particular agent (the "listing agent") for a specified period. Then, through the multiple listing service, which generally functions as an adjunct of the local Board of Realtors, the listing is printed, together with a picture of the house, and is distributed to all agents in the community who are members of the multiple listing service. Thus, in effect, the listing is placed in the hands of a great many agents, although the property is listed only with a single agent. After the listing is distributed, all agents in the service will have an opportunity to sell the property on the listing terms, thus giving it the greatest exposure for sale. The agent who produces the buyer ("selling agent") will then split the commission with the listing agent on percentages established by the multiple listing service. Because the listing agent, if he is also the selling agent, will retain 100% of the commission, he generally will be the one who will devote the greatest effort to selling the house.

While regulations of multiple listing services may require that listings be for a minimum period of time, such as 30, 60, or 90 days, these are deemed violative of federal law by the Federal Trade Commission. Real estate multiple listing services may not refuse to accept listings based on the length of the listing, the commission, the commission split, or other factors. Be aware, however, that *agents* may refuse to list a house with unusual restrictions.

Usually, the seller must obtain the written consent of the listing agent in order to withdraw his property from multiple listing prior to expiration of the agreed period of the listing. Multiple listing agreements normally provide that, even after the listing expires or is withdrawn, a liability for payment of a commission may arise if a property was shown to a person while it was listed and that person purchases the property within 120 days (or other specified period) after such termination. Although such a requirement is essential to the successful operation of a

multiple listing service, a seller should consider including in the listing agreements a requirement that the realtor, at the conclusion of the listing period, provide the seller with a list of prospective purchasers to whom the property had been shown. Before giving out the listing, however, a seller should ensure that there are no unreasonable withdrawal terms. He can ask the prospective listing agent to specify in writing the conditions under which a listing may be withdrawn. If any of the conditions appear unreasonable, the seller should have them reviewed by his attorney before giving the listing. In recent years, the Federal Trade Commission (FTC) has been investigating MLS practices in various areas of the country. These investigations have resulted in several anti-trust lawsuits and consent decrees in which various MLS practices regarding fees and listings have been nullified. If a seller believes that a particular MLS practice interferes with his ability to sell his home, he should contact his local FTC office.

B. Guaranteed Sales (Trade-Ins).

An added service provided by some real estate brokers is an agreement that if a listed home is not sold by a certain time the broker will buy the property at a specified price, but at somewhat below the listing price. A guaranteed sale arrangement may be resorted to in instances where a homeowner is seeking to buy a new home, but is unable to do so until he knows that his old home has been sold and on terms that will permit him to make the new home purchase. Selling the old home first, then buying the new home, may be an unsatisfactory solution because the new home may no longer be available when the sale of the old home is completed. A guaranteed sale arrangement, albeit at a reduced price, would assure the homeowner that he can proceed with the purchase of the new home without waiting until the actual sale of the old home. Any such listing should be reviewed carefully by an attorney before it is signed.

V. SALES CONTRACT.

The first step in a real estate transaction is the preparation and execution of a purchase agreement between the buyer and the seller. This document may be called a sales contract, purchase agreement, contract for deed, offer to purchase, contract to purchase, earnest-money contract, or deposit receipt. (The term "sales contract" will be used here for convenience.) Whatever it may be called, this instrument is the most important document in a transaction. It establishes the legal rights and obligations of the parties. As a legally binding instrument, it governs essentially all aspects of the transaction. Sales contracts can vary as to their terms, length, and detail -- from one page to a dozen or more. Regardless of its length and detail, in order to be legally enforceable, the instrument must contain enough information to establish all of the legal elements necessary to the formation of a contract. In addition, it must satisfy the Statute of Frauds, enacted in some version by every state, which requires that the essential details of an agreement for the sale of real property be in writing in order to be enforceable.

Frequently, a printed form contract is used, usually supplied by a real estate broker or title insurance company. While there is no such thing as a standard form real estate contract, there is usually some uniformity of format and content in contracts used in a particular area. Although there are great variations in printed forms, the terms and conditions of a typical form tend to favor the interests of the seller. Many provisions of a printed form, however, can be modified, supplemented, or deleted prior to execution in order to provide added protection to the purchaser

or to otherwise meet the specific requirements of the parties. These changes are, of course, a matter of negotiation between the buyer and the seller. Form contracts customarily have a blank space for additional provisions, or additional provisions may be included in an addendum to the contract. Both buyer and seller may have reasons to include a number of additional provisions. All contracts to some extent need to be tailored or styled to the particular transaction. The importance of the assistance of counsel either to draft or review the contract--prior to its execution--cannot be overemphasized.

In most instances, the buyer initiates the transaction by signing a sales contract prepared by his attorney or a real estate broker. (For newly-built homes, the builder-seller may require that his form contract be used.) The signed document is then presented by the broker to the seller (or directly by the buyer to the seller in the absence of a broker) and constitutes an offer to purchase the property upon the terms and conditions specified therein. A contract exists if the seller accepts (manifested by signing the document) without any qualification or change, and before any withdrawal or expiration of the offer. If the seller makes changes to the document and signs it, it becomes a counteroffer which can be accepted or rejected by the buyer. Negotiations may follow until the parties reach full agreement.

In lieu of executing a detailed sales contract, the practice in some areas of the country is for the parties initially to sign a "binder" which sets forth the principal terms of the transaction and provides for a deposit. The parties then proceed to the negotiation and execution of a more formal contract. A binder may or may not constitute a legal obligation. It depends on the actual terms contained in the instrument, the intent of the parties, and the particular jurisdiction of the transaction. Accordingly, in executing a binder agreement, a party should assume that he will be legally obligated unless the instrument clearly indicates otherwise.

There are, of course, other methods and procedures for initiating a real estate transaction. An informal method is the use of a so-called "receipt" which is designed as a substitute for the home-drafted initial agreement that buyers and sellers sometimes execute if there is no real estate agent involved in the transaction. In situations where the parties, not dealing through an agent, believe that a satisfactory understanding has been reached and each wants to tie the other's hands to a limited extent until the advice of counsel can be obtained, an appraisal made, or financing checked, the receipt could serve this purpose. The receipt is a relatively simple instrument which is binding to some degree by providing for a nominal fixed-sum liability (e.g., $100 to $200) on a party for failure to complete the transaction. The parties would attach to the receipt an unsigned sales contract, usually prepared by the seller's attorney, which the parties contemplate executing. The receipt states the time and place where the parties shall meet and execute the contract and specifies the fixed amount to be paid by either party for failure to consummate the transaction. A variation of the receipt is the option to buy. If the buyer is interested in the property, but wants additional time to consider the matter without losing the opportunity to purchase it, he may ask the seller to grant him an option to buy for a certain consideration. The amount paid for the option would serve to compensate the seller for tying up the house during the life of the option.

A. Provisions of a Sales Contract.

The following is a brief discussion of the customary provisions included in a sales contract, as well as other provisions that serve to protect the interests of one party or the other. (In the purchase of a new home or home under construction, special attention should also be given to the matters set forth in the later section entitled "Purchase of New Homes, Homes Under Construction and Home Improvements.")

1. The Parties.

All persons necessary to consummate the purchase and sale of the property should be parties to the sales contract. With respect to the sellers, this includes all persons required to sign the deed in order to convey title. If the seller is married, it is important that his spouse join in the commitment to sell. (If the seller is not married, this should be specified in the contract.) The reason for joining a spouse is that residential property is generally held jointly by a husband and wife. Even when property is not held jointly, a spouse may have a contingent interest, such as dower rights. Thus, in order for the seller to convey clear title, his spouse must agree in writing to join the deed conveying the property. The capacity or status of the parties should also be specified if they are not acting in their individual capacity. For example, a party may be acting in the capacity of a trustee, executor, guardian, partner, agent, or corporate officer. All named parties must also sign the contract. The date that the contract is signed should also be entered.

2. Description of the Property.

The contract must identify the real property in sufficient detail so as to preclude any misunderstanding. There are various ways to describe property, such as setting forth the legal description of the property, the street address, reference to a recorded plan, a lot number, or to a prior conveyance. The preferred practice is to set forth the legal description. For further identification, the street address can also be inserted following the words "also known as". If there is a serious question as to the exact boundaries of the property, the contract should provide that a survey be made. (If the transaction involves new financing, a lender may require a survey.)

In addition to the land description, the contract should also state that the sale includes all buildings and improvements on the land, including fixtures if, of course, that is the intent of the parties. Fixtures is a legal term which includes items that are physically attached, with some permanency, in or to the home (e.g., cabinets, TV antenna, venetian blinds, storm windows, heating and cooling systems, chandeliers, etc.). All fixtures are considered part of the house and are included in the conveyance of the real property unless specifically excepted in the sales contract. In some instances, it may not be clear whether an item constitutes a fixture. Frequently, local practice and custom may dictate as to what is considered a fixture. When in doubt, the sales contract should expressly state whether a particular item is included in, or excluded from, the sale.

In addition to the land, house, and fixtures, there may be a number of unaffixed appliances and other personal property that may be included in a sale. These items should also be enumerated in the sales contract. Examples of such property include:

- Cooking range and oven
- Window air conditioners
- Refrigerator
- Clothes washer and dryer
- Dishwasher
- Fireplace equipment
- Carpets and rugs
- Draperies
- Garden and lawn equipment
- Outdoor statuary

Also, if membership in a community pool or other community facility is to be sold with the property, this should be specified in the sales contract. The prevailing practice is to include such membership rights in the sale.

3. Purchase Price and Payment Terms.

The contract should set forth the purchase price, or at least be clearly ascertainable, and the method and terms in which payment is to be made. (If a contract is silent as to payment terms, it is presumed that the buyer will pay the entire purchase price in cash.) The contract should specify the amount that will be paid in cash, including the amount of the initial down payment or earnest money, and the balance which is to be financed through one or more loans. The source of all financing (e.g., VA, FHA, conventional, assumption, and seller financing) should be clearly specified as well as the terms of the financing (e.g., interest rate and loan maturity.) Except in cases where the parties have already arranged for all necessary financing and the buyer has received a binding loan commitment from his lender, the contract should, to protect the buyer, specify that the agreement is contingent upon the buyer obtaining all such financing within a specified time. To protect the seller, the contract should obligate the prospective buyer to make a diligent effort to secure the proposed financing. In view of the inclusion of a financing contingency, the seller should, before executing the sales contract, review the credit worthiness of his prospective buyer so as to be reasonably satisfied that the buyer has sufficient financial resources and income to qualify for the proposed financing. Many real estate agents will now attempt to "pre-qualify" or ascertain the credit worthiness of buyers when the house hunting process begins. As sellers who are not developers generally do not have access to credit reports on prospective purchasers, they may ask a representative whether the purchaser has sufficient income to qualify for the anticipated mortgage. For example, most banks use formulas in determining mortgage eligibility. If the standard keys the maximum mortgage to 2½ times annual income, then a purchaser applying for a $75,000 mortgage would

be asked to represent income of not less than $30,000 per year. The seller should also consider placing a limit on the number of points he is willing to pay to assist the buyer in obtaining the proposed financing. In some jurisdictions, the sellers will renegotiate the selling price upward, to reflect this absorption of points, if FHA or VA financing is used.

Frequently, a buyer must sell his existing home in order to come up with enough funds to purchase his new home. In such cases, a common practice is to include a provision in the sales contract for the new home that the agreement is contingent upon the sale of the buyer's old home within a specified period, usually 30 to 60 days. In the event the buyer's home is not sold within the specified period, then the agreement on the purchase of the new home is null and void and all deposits are returned to the buyer. If the seller agrees to such a contingency, he may wish to gain some protection by adding a contingency removal or a so-called "kick-out" clause to the sales contract. That clause provides that if the seller should, during the specified period, receive a written offer from another person which is satisfactory to the seller then the contract is null and void unless the buyer agrees to delete from the contract the contingency on the sale of his old home.

4. Earnest-Money Deposit.

When a contract is signed, it is customary for the buyer to make an earnest money payment or deposit of a specified amount which is to be applied toward the purchase price. The deposit serves as evidence of the buyer's good faith and as security for his performance of the contract. In the event the buyer fails to complete the transaction in accordance with the agreed terms and conditions, the contract will usually provide that the seller or the seller and the agent will be entitled to the deposit. The amount of the deposit is a negotiable item. To protect his deposit, the buyer should insist that it be held in escrow by a third party, such as an attorney. In many areas of the country real estate agents have such escrow accounts and will act as escrow agents. The buyer may also ask that the deposit be maintained in an interest bearing account with the interest credited to the buyer. This too is a rarity. Generally, in the absence of such a provision, the buyer will not be entitled to interest on the deposit.

5. Quality of Title.

The description of the property identifies the physical boundaries of the land (and improvements) that is being conveyed. The quality of title indicates the nature of the legal interest or estate in the land that will be conveyed. If the sales contract is silent, then state law will govern as to the quality of title that the seller must convey or the buyer must accept. State laws may vary widely, from requiring the seller to convey title in fee simple absolute, subject to no easements, restrictions, liens, or encumbrances whatsoever, to requiring the buyer to accept a quitclaim deed which conveys whatever interest, if any, the seller has in the property including all easements, liens, and restrictions. The prevailing practice is for the parties to agree that the seller will convey a good and marketable title, which is generally understood as a fee simple absolute title or estate free of liens and encumbrances, excepting certain easements and restrictions of record. (This allows the settlement agent or attorney to pay off any existing mortgage or other debts from the proceeds of the sale before disbursing any funds to the seller.) The parties may also agree that the title will be insurable by a title insurance company at regular

rates. In addition to the quality of title, the sales contract may specify the type of deed that will be used to convey the property. If the contract is silent, the practice is to use the type that is customarily used in the community. The type of deed may be significant in that it establishes the buyer's subsequent rights of recourse against the seller in the event of defects in the title.

There are essentially three types of deeds in general use: (i) the general warranty deed, (ii) the bargain and sale or special warranty deed, and (iii) the quitclaim deed. The general warranty deed contains the full covenants of title, which is generally comparable to the five covenants of old English common law (right to convey, quiet possession, free from encumbrances, further assurances, and no act to encumber). The bargain and sale deed contains a covenant that no defects in title were created by the grantor (seller), but makes no covenants as to pre-existing defects. The quitclaim deed contains no covenants, and, with few exceptions, is not used as an instrument to convey title in the sale of a residence.

While a general warranty deed would be most preferable to the buyer, the need for such an instrument is essentially eliminated if the buyer obtains title insurance on the property. In essence, title insurance is a contract of indemnity against loss arising out of defects in or lien on the title to real property. The use of title insurance is predominant in urban localities and its use is growing in other areas as well. Most institutional lenders require title insurance as a lending condition. Bear in mind, however, that a title insurance policy issued only to the lender does not protect the buyer. For his own protection against title defects, the buyer will need an owner's title policy. This should include a fair market value rider which provides additional coverage in excess of the sales price. The need for extra coverage is critical in light of meteoric increases in real property values in certain parts of the country.

6. Condition of the Premises.

Generally, if the sales contract contains no provisions as to the condition of the house, it is sold in an "as is" condition. The majority view is still that no warranties as to condition apply, except in cases where the buyer can establish fraud or misrepresentation. However, a minority of states, including California and Florida, have established certain warranty-type statutes, which apply to the sale of existing homes. The clear trend, however, is for courts to imply certain warranties, even in "as is" sales, especially with regard to items considered directly related to habitability of the premises. A common practice is to include a provision in the sales contract that the property is sold "as is," but that the heating, cooling, electrical, plumbing and other mechanical systems, and all appliances are in good operating condition. The buyer may also attempt to expand the scope of the warranty to include such items as the house structure, roof, and dry basement. Understandably, a seller is likely to resist the inclusion of such warranties. The subject is clearly a matter for negotiation between the parties. Whatever warranties are provided, the contact should also state that the buyer has the right to a pre-settlement inspection of the house. Homeowner warranty plans are one way in which buyers can protect themselves. Such plans will cover many major parts of a home for a fixed fee, often paid by the seller. (See Home Owners Warranty (HOW) Program section below.)

In most instances, there will be some warranties in new construction. In fact, any contract of sale or new construction without warranties should be viewed with suspicion. In

addition, most states now recognize certain implied warranties at common law for new construction.

Buyers should also consider retaining the services of an independent home inspection company to assess the condition of the home and all systems. Ideally, a buyer should seek to include a contingency inspection clause in the contract, which permits the buyer to rescind the contract within three to five days from the date of signing, if he is dissatisfied for any reason with the independent inspection report. The inclusion of such a contingency provision could serve as a compromise to the inclusion of a warranty clause that is unacceptable to the seller.

7. Termite, Well, and Septic Certificates.

It is now fairly common practice to include a provision which requires the seller to furnish at settlement a certificate from a professional termite company that the property is free of active termite infestation. Similarly, if the property has well water or a septic system, it is customary to require the seller to furnish a certificate from the appropriate government agency that the water is potable and that the septic system is in good working order. Buyers should insist that such provisions be included in their sales contracts.

8. Settlement Date and Possession.

The contract should specify the date and place of settlement. Frequently, printed form contracts will state that settlement shall be "on or before" a specified date. Sufficient time must be allowed in order to conduct a title search, arrange for financing, and prepare closing documents. If the contract is silent as to a settlement date and place, it usually will be interpreted that the parties intended a settlement within a reasonable time and at a place reasonably convenient to all parties. However, to avoid delay, misunderstanding, and the risk of litigation, the date and place of settlement should be specified in the contract. If time is critical, then "time is of the essence" clause should be used. As a practical matter, opposing counsel will generally object to this clause.

The contract should also state that possession of the home shall be given to the buyer at settlement if that is the intent of the parties. Occasionally, the parties may agree that the buyer may take possession prior to settlement, or conversely, that the seller will remain in possession for a specified period after settlement. Any such arrangement regarding possession should be set forth in the contract. In addition, the parties should execute an occupancy agreement, in effect a lease, which sets forth the terms and conditions of the occupancy, including any rental charge. If the property is under lease to a third party, which extends beyond the settlement date, the contract should indicate that the buyer purchases the property subject to the lease. The contract should state that the seller will assign the lease and all rental security deposits to the buyer at settlement. The contract should also state that the buyer agrees to assume the obligations of the seller, as landlord, under the lease upon assignment.

9. Risk of Loss.

Generally, under property law, the risk of loss to the property (due to fire, acts of God, vandalism, etc.) shifts to the buyer the moment the contract of sale is executed unless there is a

contrary provision in the contract. It is customary for the contract to provide that the seller continues to bear the risk of loss until settlement. Unless a buyer is willing to assume this risk, he should insist that this provision be included in the sales contract. The seller should then keep his hazard insurance on the property in effect until settlement. The buyer should be prepared to have his own hazard insurance in place to take effect at settlement. (Almost all lenders will require that appropriate hazard insurance be in effect as a lending condition.)

10. Certificates of Occupancy.

Where applicable, all contracts should require sellers to provide certificates for the original building and any additions, as well as all underwriters' certificates for compliance with electrical codes. If the construction predates the building code, the seller should be required to produce a letter from the representative municipal authority to that effect.

11. Closing Costs and Apportionments.

Some printed form contracts do not fully specify which party pays each of the various closing costs involved in a real estate transaction. Instead, there is a tendency to rely on the customary practice in the area. The parties, of course, are not bound to follow custom and may negotiate as to which party is responsible for any of the costs. Whatever agreement is reached as to closing costs, it should be included in the sales contract. Some typical closing costs that may be the subject of negotiation include surveys, appraisals, title examination and title insurance, lender's points, document preparation, notary fees, transfer taxes, and recording fees and taxes. In addition to closing costs, there are certain other changes that typically are apportioned between the parties. These are charges against the property which span a period of time, such as property taxes, rents, water and sewer charges, and homeowners association dues. It is customary to allocate these charges on the basis of the percentage of the period that each party is in possession of the property. All of these costs and charges are generally listed in the HUD-1 form which is given to the buyer before closing.

12. Remedies for Default.

All states have laws, either statutory or common law, which provide certain remedies to a party if the other party defaults on the contract. These remedies, such as damages, specific performance, and loss of deposits, are available even if the contract is silent as to any such rights or remedies. Most printed forms contain provisions that specify the respective rights of the parties in the event of default. Generally, these provisions will be slanted in favor of the seller. Typically, they will provide that the seller may retain the buyer's deposit and be entitled to pursue such other remedies provided by law. They also usually provide that if the seller is unable to convey a marketable title the contract is null and void, although some form contracts may provide that the seller is obliged to incur a reasonable expense to cure title defects. If possible, the contract should provide for recovery of all out-of-pocket expenses, e.g., survey, title search, and mortgage applications costs, if seller cannot convey marketable title.

13. Broker's Commission.

If either party, typically the seller, has engaged the services of a real estate broker, the contract should include a provision indicating the amount of the commission, who is entitled to it, and which party is to pay it. If there is no broker involved in the transaction, it may be desirable to include a provision in which each party represents that they have not engaged any broker and that each party will indemnify the other party against any subsequent valid claim of a broker's commission.

14. Merger Clause.

A basic doctrine of property law in most jurisdictions is that, unless the sales contract or deed provides otherwise, upon the delivery and acceptance of the deed the seller's covenants in the sales contract are superseded by and "merged" into the deed. This means that after settlement the buyer has no recourse against the seller with respect to covenants in the sales contract, except for those covenants contained in the deed. Thus, a number of the provisions in the sales contract of benefit to the buyer can be lost after settlement by virtue of the merger doctrine. The operation of this doctrine may be overcome by the inclusion of a survival clause in the sales contract which states that the provisions of the contract shall survive the execution and delivery of the deed and shall not be merged therein.

15. Miscellaneous Provisions.

Most printed forms will contain a number of fairly boilerplate provisions, such as assignment, death of a party, and unenforceability of oral terms or representations. Generally, a sales contract may be assigned to a third party unless the contract specifically precludes assignment. Of course, a party is not released from his obligations under the contract by virtue of his assignment. Similarly, the death of a party prior to settlement does not affect the obligations under the contract, unless the contract specifically provides otherwise. The contract then becomes the obligation of the deceased party's estate. Finally, it is common to include a so-called integration clause which states that the contract is the entire agreement between the parties and that any term, warranty, or representation, oral or written, not included in the contract is unenforceable.

16. Expiration of Offer.

There is, of course, no legally binding agreement until the contract is executed by both the buyer and seller. In order to protect the party that executes first, almost always the buyer, it is appropriate to include a time limit (e.g., 48 hours) for the other party to sign the contract. If the second party fails to execute the contract within the specified time limit, the first party's execution (i.e., his offer) is considered revoked.

B. Purchase of New Homes, Homes Under Construction, and Home Improvements.

1. New Home Purchases.

The purchase of a newly constructed home from a builder does not differ significantly from an existing home purchase. There are, however, several matters of importance to the buyer that deserve special attention. Local law may require the builder/seller to observe or comply with some of the items. Others must be included in the sales contract in order to bind the seller.

a. Compliance with local law.

The builder should warrant that all construction complies with local zoning laws and building codes and that all building permits and certificates of occupancy have been obtained.

b. Water and Sewer.

The builder should warrant that the water and sewer systems have been installed and are in operation. If a septic tank system is installed, the builder should warrant that it complies with local law requirements.

c. Mechanic's Liens.

The possible filing of a mechanic's lien is an ever present problem in the purchase of a newly constructed home. Almost all state laws provide that if the builder has not paid off all contractors and suppliers who furnished labor or materials for the home, they have a right to claim a lien on the house for a specified period, generally 60 to 90 days, after the last work has been completed or the last materials furnished. These liens are valid regardless of whether the purchaser knew of them. New home purchasers (or even purchasers of older homes with recent improvements) should give careful attention to this potential problem. In some states, the owner's title insurance policy will protect against such unrecorded liens. In other states, unrecorded liens are excluded from coverage. Questions about what is excluded from title insurance coverage should be directed to an attorney. Alternatively, the purchaser might attempt to add a provision in the sales contract to delay disbursement of funds until the time for filing liens expires. Purchasers might also attempt to get a bond securing against unrecorded liens. Builders will be extremely reluctant to agree to either delayed disbursement or bonding. In any event, the contract should provide that the builder will furnish an adequate release or a waiver of liens affidavit. Lending institutions will generally require such protection.

d. Uncompleted Work.

If the house is not fully completed, a list of all unfinished work should be attached to the sales contract. This work should be completed prior to settlement. If not completed, a portion of the purchase price should be held in escrow until the work is completed.

e. Construction Warranties.

The law as to warranties on new homes is changing. Courts are beginning to abandon old property laws based on feudal relations that imposed no warranties on the sale of realty. There is now a growing recognition of implied warranties against faulty construction. Nevertheless, buyers should insist that their contracts include specific warranties against defects in workmanship and materials. The builder should also be required to assign all manufacturers' warranties on appliances.

f. FHA and VA Required Warranties.

On newly constructed homes that are sold under FHA or VA financing, builders are required to give a warranty that the dwelling is constructed in substantial conformity with the plans and specifications as approved by FHA.

This process normally requires approval before construction begins. If a builder does not get such approval, he can request a one-time exemption from this requirement as long as he gives a one-year warranty on the construction. This warranty is in effect for one year which begins when the buyer takes title to the new home or when the home is occupied, whichever occurs first. If during the first year defects occur which appear to be covered by the warranty, the homeowner should ask the builder, in writing, to correct the defects. If the builder fails to make the corrections, the owner should contact the nearest FHA field office for assistance. If FHA agrees that the defects are covered by the warranty, it will use its influence to persuade the builder to make the corrections. In addition to the builder's one-year warranty, FHA is authorized to assist owners of new homes with substantial structural defects that develop within four years from the date of the FHA-insured loan. Such assistance includes correcting the defects at FHA's expense, paying the claims of the owner arising from such defects, or purchasing the property from the owner. Claims should be filed with FHA's nearest field office and must be made within four years of the date of the FHA-insured loan.

g. Home Owners Warranty (HOW) Program.

In 1974, the National Association of Home Builders (NAHB) instituted a program to provide new home buyers with a builder's warranty backed by insurance. The program, entitled Home Owners Warranty, or HOW, is administered by the Home Owners Warranty Corporation, a subsidiary of the NAHB. HOW warranties are now offered by over 17,000 member-builders of the NAHB on new homes in 48 states. Close to one million homes constructed since 1974 are covered by HOW warranties. The program works as follows. At the time of closing, the builder and buyer sign the HOW agreement, which sets forth the rights and obligations of the parties. In addition, the buyer is given the HOW Consumer Information Booklet, which explains the program, including procedures for resolving disputes. In brief, the agreement provides that the builder warrants against defects in workmanship and materials for one year, defects in the electrical, plumbing, heating, and cooling systems for two years, and major structural defects for ten years. The buyer is protected by warranty insurance in the event the builder fails to correct defects covered by the agreement. In the event the home buyer sells his home within the ten years, the remaining HOW protection is automatically transferred to the new owner. The builder

pays for the cost of the HOW, including insurance premiums. The cost is passed on to the buyer in the sales price of the home. A similar program now exists for resales of existing homes, through which a seller can insure his home for a specified time period after sale. This is often used as a marketing technique by realtors.

Additional information on the HOW Program may be obtained from the Home Owners Warranty Corporation, National Housing Center, 15th and M Streets, N.W., Washington, D.C. 20005.

2. Purchase of Homes Under Construction.

In addition to the items discussed above, there are several provisions that should be carefully addressed in the sales contract on purchases of homes to be constructed or in the process of construction.

a. Plans and Specifications.

These should be attached to and made a part of the sales contract. All building materials, appliances, decorations, and extras should also be itemized.

b. Deposit Money.

As protection against the eventuality of the builder's bankruptcy or failure to complete construction, the purchaser's deposit should be placed in escrow with a third party (e.g., attorney, real estate agent, mortgage lender, or title company).

c. Completion Date.

The buyer should attempt to get a firm completion date. For added protection, it would be preferable for the contract to provide for both a commencement and completion date. If the stated completion date is not met, the buyer should have the right to terminate the contract with return of all deposits. If possible, the inclusion of a penalty provision for late completion would be most valuable to the buyer. The contract should include a "time is of the essence" clause to insure the validity of the penalty provisions.

3. Home Improvements.

Before contracting for the renovation or remodeling of an existing home, there are a number of protective measures that a homeowner should consider. First, the contractor selected should be properly licensed by the local authorities. He should also have appropriate workmen's compensation coverage against possible claims by workers injured on the job. The contract should specify in detail the work to be performed and all terms and conditions as to the rights and obligations of the parties. Frequently, the form contract supplied by a contractor will be quite brief with only minimal provisions. A more ideal standard form contract is that developed by the American Institute of Architects (AIA Form No. A107). A copy of this form may be obtained directly from the AIA, 1735 New York Avenue, N.W., Washington, D.C. 20006. Some contractors may resist the use of any contract form other than their own, but this is a matter

for negotiation. The following are a number of provisions that should, in any event, be covered by the contract.

a. Payment Schedule.

Most contractors will require that progress payments be made as the work is performed. The payment schedule should be carefully worked out so that the payments reasonably correspond to the work progression. The final payment, of at least 10 to 15 percent, should be withheld until the work is satisfactorily completed. In addition, the contractor should furnish a release of mechanics' liens signed by the contractor and his subcontractor before the final payment is made. One possible method of structuring such payments is to use a third party, such as the architect, to certify and release interim payments.

b. Performance Bond.

If possible, the homeowner should negotiate for his contractor to provide a bond guaranteeing the performance of the contract. If the contractor then fails to perform, the bonding company would take over to ensure completion of the contract.

c. Completion Date.

The contract should specify a date when the work is to commence and when it is to be completed. Homeowners should also attempt to include a penalty provision for late completion. As in new construction, a "time is of the essence " clause should be added as a matter of course.

d. Warranties.

The exact terms of the warranty that the contractor is to provide should be set forth in the contract. To resolve disputes, the parties should consider including an arbitration provision.

e. Building Permits.

The contract should clearly indicate who is responsible for obtaining all required building permits. Before entering a contract, homeowners should also be certain that their remodeling or renovation plans are not in violation of zoning laws and covenant restrictions.

VI. FINANCING THE HOME PURCHASE.

With the exception of an all cash transaction, the purchase of a house requires some form of long-term financing. The traditional method of obtaining financing is through a mortgage loan, which means that the home to be purchased is used as security for the repayment of the loan. Generally, a home buyer takes out a new mortgage loan to finance his purchase, but such financing might also be obtained in part by assuming an existing mortgage on the home. A mortgage loan is customarily amortized over an extended period through monthly level payments of principal and interest computed so that the loan is fully paid off at maturity.

There are three basic types of mortgage loans: an FHA-insured loan, a VA-guaranteed loan, and a conventional loan, which may be privately insured. Until recently, these loans have all had a fixed rate of interest over the entire repayment period. Now there are a variety of mortgage loans in which the interest rates or monthly payments may change during the course of the loan.

Mortgage loans may be obtained from a variety of financial institutions. The lending policies, corporate charters, and applicable statutory and regulatory limitations differ among these various institutions. Consequently, features such as loan-to-equity ratios, interest rates, discount points, maturities, and other terms may vary among such lenders. Prospective home purchasers should shop several lenders to assure the most favorable terms and conditions suitable to their needs and circumstances.

A good starting point is to inquire at the institution where one maintains a savings account. If a buyer is working with a real estate agent, a service of the agent is to assist in obtaining the best available financing.

A. Sources of Financing.

The predominant sources of financing for home purchases are savings and loan associations, which may be either state or federal chartered institutions. Most loans made by such associations are conventional, but they also make FHA-insured and VA-guaranteed loans. Commercial banks (federal and state chartered) and mutual saving banks are also major sources of financing, principally for conventional loans. Other lenders, principally as secondary sources, include life insurance companies and pension funds, and, to a lesser extent, credit unions, real estate mortgage trusts and private lending companies. There are also some federal agencies that provide direct loan funds (e.g., the Farmers Home Administration). In addition, individuals are sources of financing, particularly in cases where the sellers of homes are willing to take back a mortgage for a portion of the purchase price.

Mortgage bankers or brokers are also a major loan source, primarily as originators for VA and FHA loans. The term "mortgage banker" is somewhat misleading in that it implies a depository institution, which it is not. Instead, mortgage bankers serve as middlemen, arranging loans and then selling them to other lenders and investors (e.g., life insurance companies) in the secondary mortgage market.

B. The Secondary Mortgage Market.

Approximately $100 billion of home mortgage loans are made each year by the various institutional lenders. The majority of these loans are held by the original lenders. However, about 40 percent are sold to other institutions in what is called the secondary mortgage market. This market is not an organized trading exchange (such as the New York Stock Exchange), but rather an informal, nation-wide network of trading relationships that have been developed over the years by financial institutions. Basically, the secondary market involves the selling and reselling of home mortgages after their origination and, as such, represents a key source of replenishing funds for mortgage lending. The original lender continues to service a loan even

though it may have been sold. The borrower continues to make payments to the original lender, who in turn, transmits the payments to the holder of the loan.

The federal government has assisted in the creation and maintenance of the secondary mortgage market through the establishment of the Federal National Mortgage Association (FNMA), the Federal Home Loan Mortgage Corporation (FHLMC), and the Government National Mortgage Association (GNMA). These institutions do not make mortgage loans to home buyers directly. Rather, they buy such loans from the original lenders. Through their mortgage purchases in the secondary market, they channel additional funds to the primary mortgage lenders. In addition, their secondary mortgage operations have caused the standardization and uniformity of a number of forms (e.g., notes, mortgages, and deeds of trust) as well as procedures employed in real estate transactions throughout the country. This secondary market is also crucial for the development of new financing options, since only those options approved for resale on the secondary market will gain wide acceptance.

Through its purchases in the secondary market, the FNMA (commonly called "Fannie Mae") is now the nation's largest investor in home mortgages. Chartered by Congress, the FNMA is a privately owned and operated corporation. The types of mortgages that it purchases include conventional, FHA-insured, and VA-guaranteed loans. Condominium loans are also purchased. Conventional mortgages purchased by the FNMA must conform to the FNMA requirements, such as loan-to-value ratios, loan maturity, escrowing of taxes, hazard and mortgage insurance premiums, title insurance, and the use of FNMA forms for such legal instruments as promissory notes, mortgages, and deeds of trust. Mortgage loans that meet FNMA requirements are called conforming loans.

The Federal Home Loan Mortgage Corporation, commonly called "Freddie Mac," was created by Congress in 1970 as part of the Federal Home Loan Bank system. Its primary function is to purchase conventional mortgages from federal savings and loan associations. Like the FNMA, it also establishes requirements that must be met for mortgage loans to qualify for purchase by the FHLMC.

The third entity, the Government National Mortgage Association (GNMA), commonly called "Ginnie Mae," is a government corporation that serves to facilitate the secondary mortgage market by guaranteeing mortgage-backed securities issued by mortgage originators.

Although these three institutions do not make loans directly to homeowners, it is important to recognize that their operations have a significant effect on the availability of funds for home loans and on the terms of such loans.

C. Assumption of an Existing Loan.

Whether a home is to be sold with the buyer assuming the existing loan on the home or acquiring new financing depends on a number of factors, such as the amount of down payment required under each, the difference in interest rates on the existing loan and new loan closing costs, and buyer qualifications. Of primary importance is whether the existing loan is assumable. Except for FHA loans, almost all loans made by financial institutions in recent years are not assumable without the written approval of the lender. Such loans generally contain "due-on-sale" clauses which operate to accelerate the maturity of a loan so as to make the outstanding

balance due and payable if the home securing the loan is sold to another person without the prior written approval of the lender. Generally, lenders will not approve an assumption if the interest rate on the loan is lower than the then-current interest rates, although they may permit an assumption on the condition that the interest rate will be increased. The Garn-St. Germain Depository Institution Act of 1982, 12 U.S.C. §§ 1701j-3 (1982), makes all "due-on-sale" clauses in loans made after October 15, 1982, valid and enforceable. Accordingly, before agreeing to sell on an assumption, sellers should confirm that such a clause is not in their mortgages or that any required approval will be given by the lender.

Under an assumption, the buyer assumes responsibility for the existing loan, but the seller continues to be primarily liable to the lender because the assumption agreement is only between the buyer and the seller. The following example illustrates the extent of the seller's potential liability:

Assume that the seller has an existing mortgage loan on which the remaining balance is $36,000 at the time the house is sold to the buyer who assumes the loan. In the event that the buyer fails to make required payments on the loan, and the mortgage is foreclosed and brings only $34,000 at a foreclosure sale, then the seller, being still primarily liable on the loan, would be liable for the $2,000 deficiency. Since the buyer agreed to assume and pay the loan, the seller would have a right of recourse for the $2,000 against the buyer for whatever this right might be worth. For these reasons, it is important that a seller assure himself that his buyer has a sufficient equity investment in the house to cover the possibility of a deficiency judgment.

The buyer on an assumption pays the seller in cash the difference between the balance due on the loan and the purchase price, or gives the seller part cash and a promissory note for the balance secured by a second mortgage on the property. A seller who obtains sufficient cash from the buyer to assure that the buyer will not forfeit his down payment by defaulting on the existing loan generally has little risk in permitting a buyer to assume his loan. However, in areas where a substantial depression in the housing market may occur as a result of local conditions (e.g., a base closing), the seller should consider this factor in determining whether he will sell on an assumption or require that the buyer obtain new financing. In any event, on an assumption, a seller should require a credit report on the buyer and should make the sale contingent on seller's approval of the buyer's credit as a means of ensuring that the buyer is financially responsible.

On FHA and VA loans, it is possible for the seller to be released from liability following an assumption if the buyer meets FHA or VA qualifications (but the buyer does not have to be an eligible veteran to meet VA qualifications). Many lenders have, however, adopted a policy of not approving a release. On any assumption, unless the seller is released from liability, the seller should keep the mortgage lender informed of his address.

In lieu of an assumption, a buyer could purchase the property "subject to" the mortgage securing the existing loan. Under the "subject to" sale, the buyer is not legally obligated to pay the existing loan. But, even though he is not personally liable, his failure to make payments would ultimately result in foreclosure and the loss of his equity in the property. Nevertheless, because of the absence of any personal liability of the buyer, a seller should seek advice of counsel before selling on a "subject to" basis.

When new financing is obtained, the existing loan is paid in full from the proceeds of the buyer's new loan and the seller is released from liability. On its face, it would thus appear that the seller should always insist that his buyer obtain new financing. Several factors, however, militate against this conclusion. First, in the case of an assumption, the seller may avoid a prepayment penalty for early payment of his loan. (This may be as much as one to three percent of the outstanding loan balance.) Second, both the buyer and seller might avoid the payment of discount points that would be involved in new financing. Furthermore, closing costs may be significantly reduced and the buyer may not have to meet credit standards required by lenders for new financing. These factors, together with the fact that the existing loan may carry a lower interest rate than can be obtained on a new loan, may make assuming the existing loan particularly attractive to a buyer and facilitate the sale of the home.

Even though an existing, low-rate mortgage may contain a "due-on-sale" clause, it is still possible to work out an assumption arrangement with the lender. Frequently, lenders will approve assumptions with an upward adjustment in the interest rate, but to a level that generally will be below the current rate for new financing. For mortgage loans that it holds, the Federal National Mortgage Association (FNMA) generally will either permit an assumption or offer a new larger loan at an interest rate that is somewhat lower than prevailing market rates. The original lender of an existing mortgage loan can provide information on whether a loan is owned by FNMA and can provide further details concerning such FNMA resale financing.

D. New Financing.

The prevalent practice in the purchase of a home is for the buyer to obtain new financing, which may be a conventional loan (with or without private mortgage insurance), a VA-guaranteed loan, or an FHA-insured loan. All such loans are applied for through regular lending channels from the various lenders described earlier. Upon receiving a loan application, a lender will appraise the property as to its market value and obtain a credit report on the applicant from a credit investigating agency. There is generally a charge to the applicant for the appraisal and credit report.

If the house appraisal and the applicant's credit and financial resources are satisfactory, and if the lender is willing to make the loan, the lender will issue a "commitment letter" to the applicant which sets forth the basic terms and conditions upon which the loan will be made. Since the commitment letter technically constitutes an offer to make a loan, the applicant (if he wishes to accept the offer) is required to countersign the letter in order to make it binding. The letter then becomes a contract for the lending and borrowing of money on the terms and conditions set forth in the letter. It is important to note that a commitment letter will usually express an expiration date. This means that a closing must occur by that date in order to assure the availability of funds and at the stated interest rate.

Upon submission of a loan application, a lender, who most likely is subject to the provisions of the Real Estate Settlement Procedures Act of 1974 (RESPA), is required to give the applicant a good faith estimate of the settlement service charges he is likely to incur in the purchase of the home and a copy of HUD's Special Information Booklet on Settlement Costs. The booklet describes the settlement process and costs involved and explains certain rights available to a home buyer under the RESPA.

E. Conventional Financing.

The term "conventional financing" means the absence of any government (VA or FHA) guarantee of repayment of the loan. Conventional loans, and their terms and conditions, are relatively free of government regulation, although there are some controls on federally regulated institutions, such as limits on loan-to-equity ratios and collateral requirements.

Because the only security for a conventional loan is a first mortgage on the property, lenders traditionally require a down payment of 20% to 25% of the purchase price or value of the property, depending on the current mortgage market conditions. The interest rate on such loans is also dependent on the money market and in recent years has fluctuated between 7% and 16%. The U.S. Government places no ceiling on such interest rates, but some states impose limits under their usury laws. Conventional loans are generally for terms of 15 to 30 years. Discount points may be charged at the time of closing, and it is not uncommon for the lender to require one or more points from both the buyer and seller in a tight money market. Conventional loans customarily contain a prepayment penalty clause which can vary substantially. Generally, lenders follow lending practices and terms that conform with guidelines established by the FNMA and the FHLMC. Loans that conform to such guidelines, so-called conforming loans, may be sold in the secondary market to the FNMA and the FHLMC.

F. Private Mortgage Insurance.

In order to meet the demands for low down payment conventional loans and to minimize a lender's risk of default on such loans, a system of private mortgage insurance (PMI) has been developed. PMI coverage enables lenders to make home loans to borrowers that have adequate incomes, but inadequate savings to make 20% to 25% down payments. Although in existence since 1957, PMI has grown rapidly in importance only during the past decade. (PMI is sometimes referred to as MGIC, pronounced magic, insurance because the first private company to offer the insurance was the Mortgage Guaranty Insurance Company.) Under PMI, a private mortgage insurance company insures the loan, thus permitting the lender to go beyond its conventional loan limits of 75% to 80% loan-to-value ratio. In effect, PMI insures the lack of equity. With such PMI coverage, loans can be made up to 95% or more of property value, although the more common arrangement is for 90% loan and 10% cash down payment. Borrowers are charged a premium for the PMI coverage. The premiums vary, but generally they are about 2% of the amount of the loan. The premium may be payable at the time of closing (and, therefore, another item of closing costs); or it may be a combination of a payment at closing and annual or monthly premiums for a number of years. (For example, 1% at closing and ¼% annually for six years.)

G. Government-Supported Financing.

The traditional requirement of a 20% to 25%, or even 10%, down payment in conventional financing effectively precludes a number of people from purchasing a home even though they may have the income to meet monthly mortgage payments. As a means of reducing cash down payments and also protecting lenders against risk of loss on high debt-ratio loans, a program of government-guaranteed loans was developed. The program originated in 1934 with

the enactment of the National Housing Act, which established the Federal Housing Administration (FHA) and authorized government insurance against losses on home loans made by private lenders. In 1944, the VA home loan guarantee program for veterans was inaugurated with the enactment of the Servicemen's Readjustment Act of 1944. With few exceptions, U.S. Government housing programs do not involve direct government loans for the financing of home purchases. One exception is the Farmers Home Administration, which does make direct loans, as well as guarantee loans, for the purchase of homes in small towns and rural areas.

H. FHA-Insured Loans.

The Federal Housing Administration, now a part of the Department of Housing and Urban Development (HUD), administers a great number of housing programs. Only the basic programs relating to FHA-insured home loans are described in this part. Persons interested in other FHA programs should contact a HUD field office.

At the outset, it should be understood that FHA-insured loans are not government loans. FHA does not lend money or build homes. Under FHA's program, a mortgage loan is made by an approved lender and the repayment of the loan is insured by FHA. The borrower is obligated to repay the loan, including interest, over a term of years. FHA's insurance protects the lender against loss due to defaults by borrowers. Applications for FHA-insured loans are made through any lender that FHA has approved to make such loans. Almost all institutional lenders are approved lenders, but some do not handle FHA financing. The applicant deals only with the lender, who handles all details with the FHA. Lenders are not required to make FHA loans, nor are sellers required to sell under FHA financing. All parties must agree to such financing.

Homeowners who are contemplating the sale of their homes can obtain a conditional commitment from the FHA as to the amount of the loan it will insure on the sale of the home to an acceptable buyer. This can be done even before the house is listed for sale. Acquiring such a conditional commitment could facilitate the sale of the house. To obtain such a commitment, owners should apply through approved lenders.

1. The Mortgage Insurance Program.

(12 U.S.C.A. § 1709 or § 203(b) of the National Housing Act). This is the basic statutory program for FHA-insured loans for the purchase of existing housing and for the purchase or construction of new housing. Any homebuyer is eligible for such a loan if the buyer has a satisfactory credit record, the funds needed for closing, and sufficient income to meet monthly payments. There are no upper age limits for borrowers. Loans may be made for the purchase or construction of one-to-four family unit homes. Unlike VA loans, FHA borrowers are not required to occupy the house. Loans for the purchase of condominium and cooperative units are also insured by FHA under separate statutory authority.

2. Insured Mortgage Amounts.

The current maximum loan amount that the FHA will insure on a one-family dwelling varies based on housing costs in the applicable metropolitan statistical area (MSA). Usually the loan cannot exceed roughly $100,000. The maximum loan amount is figured on either (i) the

FHA estimate of the value of the property plus allowable closing costs or (ii) the purchase price, whichever is lower. For houses built under an the FHA (or VA) preconstruction commitment or inspection, or that are more than one year old, the FHA will insure 97% of the first $25,000 of a loan and 95% of the remainder, up to the insured loan maximum. (In the case of loans to refinance existing mortgages or for loans to non-occupant borrowers, the insured amount is limited to 85% of the maximum loan amount.) Thus, on the purchase of a home for $50,000 (and appraised for at least that amount), the FHA will insure $48,000 (97% of the first $25,000 plus 95% of the remaining $25,000); and the purchaser would be required to make a down payment of $2,000. In the case of a $60,000 loan, the FHA would insure $57,500 and the required down payment would be $2,500.

For homes that were not built under FHA inspection and are less than one year old, FHA's maximum insurance is limited to 90% of appraised value, up to the current insured maximum. (However, the higher percentages described above will still apply if a home is covered by a 10-year builder's warranty.) Thus, on a $50,000 loan, the FHA would insure $45,000 and the required down payment would be $5,000. This limitation is designed to encourage a builder to build a home, or a subdivision, under FHA inspection so that the home(s) will be eligible for the buyers to seek the best available financing when it is completed. It should be noted that § 203(b) loans to service members are limited to an amount that will allow the service member to have at least 15% equity in the home at the end of his expected tour of duty in the area. It should be understood that the FHA does not set the sales price of a home; it merely appraises the property for purposes of determining the amount of the mortgage loan that it will insure. The purchaser may legally pay any amount above (or below) the FHA appraisal. However, if the purchase price exceeds the appraised value, the excess over the appraised value (including the amount of the purchase price over the maximum loan amount) must be paid in cash as additional down payment. If the purchase price plus closing costs paid by the buyer (exclusive of prepaid items) is less than the appraised value, then the purchase price plus buyer's closing costs is considered the appraised value for purposes of determining the insured amount and the required down payment. An FHA appraisal includes the value of the property plus certain allowable closing costs. The total of these two items constitutes FHA appraised value and is the figure used to compute down payment requirements and the maximum loan amount that will be insured.

3. Down Payment Requirements.

The borrower's down payment (plus closing costs and prepaid items) must be paid in cash. Secondary financing (e.g., second mortgages) of down payments, closing costs, and prepaid items is not permitted. (Buyers who are 60 years of age or older may borrow money for down payment and prepaid items from an FHA-approved lender.) The FHA rule against such secondary financing prohibits a person from raising the down payment and closing costs by placing a second mortgage on the house or by means of an unsecured loan. However, such funds can be obtained through a loan secured by an automobile, corporate stock, or a life insurance policy. But keep in mind that the existence of such loans and the repayment obligations may impair the borrower's credit standing, thereby affecting the amount of the FHA loan for which the borrower may qualify.

4. Interest Rate and Loan Terms.

The maximum interest rate that may be charged on FHA-insured loans is set by the FHA and is generally one or more points below the conventional rate. The rate established by the FHA changes from time to time due to money market conditions (from 7% to 16% during the past 10 years), but the rate does not change once a loan is made. FHA rules also prohibit a lender from charging discount points to a borrower although an initial service charge of 1% of the loan amount may be charged to the borrower. (Discount points may be charged to a borrower for refinancing and construction loans.) Because interest rates on FHA loans are lower than prevailing rates for conventional loans, lenders will invariably charge discount points to the seller in order to make FHA loans competitive with conventional loans. The FHA sets no limits on the number of points that may be charged to sellers. However, since the buyer is not precluded from paying any price he chooses above the FHA appraisal, the buyer and seller may set the sales price at an amount which gives the seller sufficient cash to pay the points charged to the seller.

FHA-insured loans are repaid in monthly level payments over a term of years. For homes built under FHA inspection, the maximum maturity of the loan is 35 years or three-fourths of the FHA estimate of the remaining life of the property, whichever is less; otherwise, the maximum maturity is 30 years. Terms of 35 years are granted only under special circumstances. FHA-insured loans are assumable. In addition, prepayment penalties are limited to 1% of the original loan; and no prepayment fees may be charged if the loan is over ten years old or if a new FHA-insured mortgage is placed on the property. At closing, a lender is permitted to collect the following fees and charges from the borrower: service charge of 1% of the loan amount, appraisal and inspection fees, credit report, recording fees and taxes, title examination and insurance, preparation of documents, prepayment or escrowing of property taxes and hazard insurance, and other reasonable and customary charges.

5. FHA Insurance Premium.

The FHA charges a mortgage insurance premium of between 1/4% and 1% per annum on the outstanding balance of the loan. The premium is paid by the borrower and is collected with his monthly mortgage payment to the lender. The premium is then paid over to the FHA and goes into a special fund which the FHA used to pay its expenses, insurance losses and to maintain its insurance reserves. If the total premiums paid under the mortgage are more than that mortgage's proportionate share of the FHA's expenses, losses and reserves, the FHA will refund the difference to the borrower or to whoever else is the legal owner of the property at the time that the mortgage is paid in full. If such a refund is due, it will be paid automatically by the FHA. The homeowner need not file any application.

6. Special FHA Terms for Veterans.

A special program of insured loans under § 203(b) (12 U.S.C.A. § 1709) exists for eligible veterans to purchase one-family dwellings. To qualify, an individual must have served on active duty more than 90 days or performed extra hazardous duty, and must have been discharged or released under conditions other than dishonorable. Veteran status to qualify for this special FHA loan program is determined by the Veterans Administration. To obtain an

eligibility certificate, an individual should submit VA Form 26-8261a, which is available at VA or FHA offices. Certificates of eligibility for such loans can be issued to veterans who have already used their VA loan benefits.

The benefit to the home buyer under this program is that the FHA insures a higher percentage of the loan, thus requiring a smaller down payment. The FHA will insure 100% (instead of the regular 97%) of the first $25,000 and 95% of the remainder. The qualifying veteran, however, must pay at least $200 in cash, which may be applied to closing costs and prepaid items. All other terms and requirements are the same as for regular § 203(b) insured-loans described above. Although veterans would normally utilize their more liberal VA home-loan benefits, this FHA program may be attractive to veterans who do not qualify for, or who have already used their, VA benefits.

7. FHA In-Service Loans.

(12 U.S.C.A. § 1715m or § 222 of the National Housing Act and AR 608-8). Since 1954, the FHA has provided a special loan program for active duty personnel, commonly called In-Service Loans. While the program is currently unfunded, its statutory basis still exists and it could be reactivated in the future. The terms, conditions, and requirements for In-Service Loans are essentially the same as for regular FHA-insured loans. The major difference is the payment of the FHA mortgage insurance premium. Under the In-Service Loan program, the Department of Defense will pay the premium on behalf of a service member so long as the member is on active duty. (DOD will also make premium payments on behalf of a surviving spouse for a period of two years after the service member's death.) In addition, DOD will pay the prepayment penalty of 1% which is generally charged on FHA-insured loans that are paid off in advance of scheduled payment. To qualify, a service member must be on active duty and must have served on active duty for at least two years. Eligibility is the same regardless of rank. As part of the loan application to a lender, the service member must submit a Certificate of Eligibility (DD Form 802) issued by the applicable military department which certifies that the individual needs housing and meets the active duty eligibility requirements. (If a service member has previously had a § 222 loan, the military department must decide whether another such loan may be granted.) A service member can have only one home at a time financed with an FHA In-Service Loan. Generally, if a service member assumes a regular (§ 203) FHA loan, the borrower may have it converted to an In-Service Loan, thus saving the cost of the FHA mortgage insurance premium. Conversely, if a service member sells a home financed under an In-Service Loan and the loan is assumed by a buyer not eligible for such a loan, it is converted to a regular FHA loan and the buyer will be required to pay the FHA premium. Upon sale of the property, a service member should notify the commanding officer and ensure that a Certificate of Termination (DD Form 803) is issued and submitted to HUD. The maximum amount of an In-Service loan, the interest rate, and the repayment terms are the same as for regular FHA loans. However, In-Service Loans may only be used to purchase or to construct one-family dwellings (including condominiums) for the occupancy of the service member and the member's family. It cannot, for example, be used to refinance a home the service member already owns. In addition, the program is only available to members who received a DD 802 before 1 April 1980 and is, thus, essentially defunct.

8. FHA-Graduated Payment Mortgages.

Under § 245 of the National Housing Act (12 U.S.C § 1715z-10), the FHA administers an insured-loan program called Graduated Payment Mortgages (GPM), which is designed to provide loan funds to home buyers (including condominium purchasers) who presently have moderate incomes, but expectations of steadily rising incomes. Under GPM-insured loans, the home buyer is allowed to make lower monthly payments, tailored to income, in the early years of the loan with a gradual increase for a set number of years, followed by level payments for the balance of the loan. These loans are subject to the same requirements, terms, and conditions as regular FHA-insured loans (§ 203(b)), except for modifications resulting from the early lower mortgage payments. For example, one modification may be that a higher down payment may be required in a GPM loan to compensate for the negative amortization that may occur because the monthly payments during the early years, the graduation period, frequently do not cover the full amount of accruing interest. To the extent the accruing interest is not covered by the monthly payments, the outstanding loan balance will increase. This is negative amortization. In effect, negative amortization means that the homeowner is borrowing additional money from the lender. However, since the outstanding loan may not at any time exceed the maximum insurable loan, minimum down payment requirements for GPM loans will, in most cases, be higher than under regular FHA loans. Thus, for example, under a typical Plan III mortgage (see below), the down payment will average between 9% and 10%, which is about twice that required under § 203(b).There are five basic GPM plans which vary the rate of monthly payment increases (from 2% to 7.5%) and the number of years over which the payments increase (5 or 10 years). The greater the rate of increase, or the longer the period of increase, the lower the mortgage payments are in early years. After a period of 5 or 10 years, depending on which plan is selected, the mortgage payments level off and stay at that level for the remainder of the loan. The increases in monthly payments during the graduation period occur once each year.

The five GPM plans are as follows:

Plan	***Percentage of Increase in Monthly Payments***	***During***
I	2 1/2% each year	First 5 years
II	5% each year	First 5 years
III	7 1/2% each year	First 5 years
IV	2% each year	First 10 years
V	3% each year	First 10 years

To illustrate how a GPM loan works, the following table compares the payment schedule of a regular FHA-insured loan with a Plan III GPM loan. Based on a $50,000, 30-year loan at 11 1/2% (plus .5% mortgage insurance premium), monthly payments would be as indicated on the table below.

Year	***Regular FHA-Insured Loan***	***GPM Loan***
1	$495.50	$379.80
2	$495.50	$408.29
3	$495.50	$438.91
4	$495.50	$471.82
5	$495.50	$507.21
6	$495.50	$545.25
7	$495.50	$545.25
Remaining Payments	$495.50	$545.25

GPM loans may not be used to refinance an existing level payment loan. However, GPM loans may be refinanced to a level payment loan.

I. VA-Guaranteed Loans.

1. Eligibility Requirements.

Congress has been very generous in making most active duty and discharged service members eligible for the home loan guaranty program. All service members on active duty with the United States armed forces are eligible to participate in the program if they have served for at least 181 days. Any reservist or National Guard member with over six years of service is also eligible. Their costs, however, are slightly higher than those eligible under the traditional program.

Discharged service members are also eligible depending on the length and date of service and character of discharge. Veterans who have served in peacetime must have been on continuous active duty for over 181 days and released under conditions other than dishonorable. Enlisted personnel discharged after September 7, 1980, and officers with service after October 16, 1981, must have completed 24 months of continuous active duty or the full period of active duty (of at least 181 continuous days of active duty) and discharged or released under conditions other than dishonorable. Those soldiers serving in peacetime who have been discharged for a service-connected disability do not have to satisfy the 181 continuous active duty service requirement. Discharged reservists and National Guard members are also eligible under the new test program.

War-time veterans are eligible if they have served on active duty for at least 90 days and been discharged under other than dishonorable conditions. Service members separated for a service-connected disability may be eligible even if they were on active duty less than 90 days. World War I veterans are generally not entitled to participate in the home loan guaranty program.

Dependents of certain service members may also be eligible for VA home loans. Surviving spouses of eligible service members who died as the result of service-connected injuries are eligible for VA financing. Spouses of active duty members who are carried as missing in action or prisoner of war for more than 90 days also may qualify.

To obtain VA financing, service members meeting the eligibility criteria must obtain a certificate of eligibility from the VA. Issuance of a certificate of eligibility does not, however, constitute approval of a loan by the VA.

2. Entitlement.

The guaranty program enables veterans to obtain home mortgages, through conventional sources, without making a substantial down payment. Congress has enacted a tiered entitlement system that applies for all loans taken out after January 1, 1990.

The current basic entitlement, or loan guaranty amount, is $36,000. This amount may be increased to $50,750 or 40% of the loan, whichever is less, if the amount of the loan exceeds $144,000.

Mortgage lenders traditionally allow qualified veterans to take out loans worth four times the guaranty amount without down payment. Accordingly, veterans may be able to obtain VA-guaranteed mortgages of up to $203,000 without down payment.

It is possible for veterans to have some portion of their eligibility remaining even if they have a guaranteed loan outstanding. Because the basic entitlement has risen over the last few years, veterans who have previously used their entitlement will generally have partial entitlement remaining. For example, a veteran who used all of the 1985 entitlement amount of $27,500 to purchase a home in 1985 may now have $23,250 of entitlement guaranty remaining if the veteran takes out a loan in excess of $144,000.

Although a veteran is allowed only one entitlement, it may be restored under two conditions. The entitlement will be restored when the property subject to the VA loan has been sold and the loan paid in full. A veteran may also receive restoration of entitlement by allowing a qualified veteran to assume the VA loan and substitute his entitlement. The veteran must apply for the restoration and receive approval of the VA.

3. Qualifying Purposes.

Although the primary purpose of the home loan program is to enable veterans to buy homes, it may be used for certain other qualifying purposes. A VA loan may be used to purchase or construct residential property of up to four family units, including townhouses, condominiums, or mobile homes. The VA loan may also be used to repair, improve, or alter an existing home.

The VA home loan program may not be used to purchase property in a foreign country, to buy business property, or to buy a cooperatively owned apartment.

Veterans must certify that they intend to occupy the property securing the VA loan as a home. A recent amendment to the law, however, provides an exception to the occupancy

requirement for a veteran who is unable to occupy the property due to military service upon certification (by the spouse) that the spouse will occupy the home.

Veterans may also use their loan guaranty entitlement to obtain refinancing to make alterations, repairs, or improvements to the property. The amount of the refinanced loan may not exceed the value of the realty or the value of the existing loan, plus closing costs. The VA will not guarantee any loan for improvement or refinancing of a dwelling unless the veteran certifies that he occupies the property as a home. Veterans will, however, be entitled to VA financing if they are unable to occupy the residence due to military service, and the veteran's spouse occupies the dwelling. Another exception allows veterans to certify that they intend to reoccupy a residence after improvements are made to the property.

Veterans may also use a VA loan to refinance an existing home loan, a manufactured home loan, or a prior VA loan to take advantage of a lower interest rates. These loans must satisfy five requirements: (1) the loan must be secured by the same dwelling as the loan being refinanced, (2) the veteran must own the dwelling and either occupy or have previously occupied the dwelling, (3) the amount of the VA guaranty must not exceed the existing balance and certain closing costs, (4) the amount of the VA guaranty may not exceed the original guaranty, and (5) the term of the new loan may not exceed the original loan plus ten years. A .05% funding fee is charged on all refinanced loans.

Guaranteed loans to purchase manufactured homes and lots are also available. Recent amendments to the loan program have changed the entitlement amount, guaranty calculation, and occupancy requirements of these loans.

4. VA Financing Requirements.

Veterans obtain a VA-guaranteed loan from private commercial lenders. The VA imposes several conditions on the financing arrangement between the private lender and the veteran purchaser. A common misconception is that all lenders must accept VA-guaranteed financing. Lenders may refuse to participate in the VA home loan guaranty program and many often do. On the other hand, the VA may prevent private lenders from participating in the home loan program if they do not comply with VA procedures or if they take action detrimental to the government's interests.

Lenders who choose to participate may now charge points to a veteran purchaser, subject to negotiation and may also charge a 1% loan origination fee. The loan origination fee may be included in the amount of the loan and paid from its proceeds. The veteran may also be required to pay appraisal fees, recording fees and taxes, credit report costs, tax assessments, survey expenses, and title examination fees.

The veteran must also pay a funding fee to the lender when receiving a VA-guaranteed loan. This funding fee will be credited to the VA's Guaranty and Indemnity Fund and used to satisfy any losses that the VA may incur when paying on its guaranty in the event of default. The amount of the fee is based on the down payment made by the veteran. If the veteran does not make a down payment, the fee is 1¼% of the loan; if the down payment is 5%, the fee is ¾%; and if the down payment exceeds 10% of the loan the fee is ½%. There are additional charges for second and subsequent use of VA loan guarantees which can result in fees of over 3% of the loan

amount. Although the VA does not require any type of down payment, nothing precludes the lender from requiring one. Payment of all purchaser closing costs must be in cash. Unlike FHA loans, there is no mortgage insurance premium involved in VA home loans. Lenders may not impose any prepayment penalties on the loans and the loans must be assumable.

Most loans guaranteed by the VA are fixed-rate mortgages. The VA will, however, guarantee graduated mortgage or growing equity mortgage plans. The loan repayment for any type of mortgage may not extend beyond 30 years, 32 days.

The VA used to establish, in coordination with the Department of Housing and Urban Development, the rate of interest that the veteran paid for the mortgage loan. This rate was adjusted from time to time to keep pace with market conditions; but once the loan is made, the interest rate remains fixed for the life of the loan. The current VA program no longer sets a standard VA interest rate, but allows the veteran and the lender to negotiate both the rate and points. This has resulted in VA loans tracking market rates. Unlike most conventional loans, the interest rate charged on VA loans is based on the rate at the time of closing. Thus, veterans are exposed to the risk that the interest rate may rise after the loan has been approved. During inflationary periods, veterans can avoid this risk by taking advantage of a procedure that allows them to lock in the interest rate at the time of loan approval.

There is no limit to the number of points that may be charged for a VA loan. Under the old program, the seller was required to pay any points charged. Some courts have held, however, that the VA regulations do not prohibit the seller from making an agreement with the buyer that requires the buyer to pay some or all of the points charged. Another common practice was for the parties to agree to an increase in the home price or to overprice items of personal property to make up the amount the seller must pay in points. Since the current program of negotiable rates is a test, the old program may be reinstituted at some future date.

All homes securing VA loans must meet VA standards for construction and general acceptability. This requirement may make VA financing less attractive to prospective home sellers than conventional financing. New homes must carry a one-year builder warranty that the home has been constructed in general conformity with VA-approved plans and specifications. By guaranteeing the loan and establishing construction standards, however, the VA does not warrant the veteran's house. A purchaser may pay more than the VA appraisal only if the excess amount is paid in cash from the purchaser's own resources.

The loan application must show that the purchaser has the money for closing costs and any required down payment, and there can generally be no agreement to give a second mortgage. Fully amortizing second mortgages are permitted if the second mortgage is not at a higher rate of interest than the first mortgage. The VA tends to discourage such second mortgages and there must, in any event, be full disclosure of any such secondary financing. Unlike FHA loans, however, there is no prohibition against borrowing the money for closing costs on an unsecured note, provided the loan is reflected as a debt on the VA loan application. The amount of a VA-guaranteed loan also may be limited because of customary security requirements observed by lenders that such loans not exceed the prescribed ratio of loan amount to VA guarantee amount, generally 25% of the VA appraisal. As in the case of FHA loans, participation in the VA-loan program is voluntary, and the VA has no authority to require a person to sell his house, or a

lender to make a loan, under the program. All parties to the transaction (buyer, seller, and lender) must agree to VA financing. Eligible veterans must make their own arrangements for VA loans through the usual lending channels (banks, savings and loan associations, mortgage bankers, etc.). Real estate brokers will assist veterans in finding a lender willing to make a VA-guaranteed loan.

5. Assumption of VA Loans.

Because VA-guaranteed loans do not carry a "due on sale" clause or prepayment of mortgage penalties, they are assumable. Although this is an attractive feature of the program, it led many veterans down the path to financial disaster. Prior to 1988, there were virtually no restrictions on who could assume VA-guaranteed loans. The high rate of defaults on VA-assumed loans has led Congress to enact restrictions on loan assumptions in the Veterans' Home Loan Program Improvements and Property Rehabilitation Act of 1987. The 1987 law restricts the assumability of VA-guaranteed loans for which commitments were issued on or after March 1, 1988. Under the new law, a lender may allow a buyer to assume a VA loan only if three criteria are satisfied: 1) the loan must be current; 2) the buyer must be found creditworthy; and 3) the buyer must be obligated by contract to purchase the property and assume full liability for repayment of any unpaid balance. If all three criteria are met, the veteran is released from all liability to the VA on the assumed loan. This, however, does not reinstate eligibility for a new VA loan.

The new law contains provisions for appealing to the Secretary a determination not to allow a buyer to assume a loan. The Secretary has the authority to approve the assumption of the loan if all three criteria have been met. Moreover, even if the buyer does not qualify from a credit standpoint, the Secretary may approve the assumption if the transferor is unable to make payments on the loan and has made reasonable efforts to find a qualified buyer.

The lender may charge either the purchaser or the seller of property a fee not to exceed the lesser of $300 and the actual cost of required credit reports or a maximum charge prescribed by state law. Additionally, a fee of ½% of the loan balance must be paid to the VA by the person assuming the loan.

The penalty is stiff for attempting to circumvent the provisions of the new law by agreeing to private financing arrangements. Under the new law, a lender holding a VA loan may demand immediate and full payment of principal and interest if residential property secured by a guaranteed VA loan is transferred without notifying the lender. Certain transfers will not trigger the right of a lender to accelerate payments. A holder may not accelerate a loan in any of the following circumstances: the creation of a lien subordinate to the lender's security instrument; the transfer upon the death of a joint tenant; the transfer to a relative upon the death of the owner; the granting of a leasehold interest under three years without an option to purchase; the transfer to a spouse or children in joint tenancy; or the transfer to a spouse incident to a divorce.

The new restrictions on VA loans will help many veterans avoid financial hardships by releasing them from liability on assumed loans. The stringent underwriting requirements and the assessment of assumption fees will, however, reduce the flexibility that veterans formerly enjoyed in allowing buyers to assume their VA loans. To ensure that borrowers receive notice of

the new restrictions, lenders must include a conspicuous warning in loan instruments that VA loans are not assumable without the approval of the VA or its agents.

6. VA Direct Loans.

In lieu of VA-guaranteed loans, the VA is authorized to make direct loans to veterans in areas that have been designated as housing credit shortage areas. Such areas are generally rural areas and small towns where VA-guaranteed loans historically have not been available. The current maximum loan amount is $33,000. The terms and conditions of such loans are essentially the same as those of VA-guaranteed loans. The nearest VA office should be consulted to determine the direct loan status of a particular locality.

J. Farmers Home Administration (FMHA).

The FMHA, an agency of the Department of Agriculture, provides direct loans and loan guarantees to finance the purchase of homes in rural areas by families with low or moderate incomes. (Rural areas include open country and rural towns with populations of 20,000 or less.) Families with an adjusted annual income of less than $15,500 are eligible. Adjusted income is determined by taking the total amount of income of all adult family members from all sources and deducting (i) 5 percent of that total amount, and (ii) $300 for each minor family member. There are no maximum loan limits. Direct loans may be made up to 100 percent of the appraised value of the home and site for terms up to 33 years. The interest rate is established by the FMHA and is usually less than the current FHA/VA rate. (Direct loans are limited to those areas in which HUD has determined there is a serious lack of mortgage credit.) Loans guarantees are made on essentially the same guidelines as direct loans, except that the interest rate is negotiated between the lender and the borrower and a down payment is required in the amount of 3% of the first $25,000 of the guaranteed loan and 5% of the loan in excess of $25,000. A guarantee fee of 1% of the guaranteed loan is charged by the FMHA. Applications for direct FMHA loans are made to the FMHA county office serving the particular area. Applications for guaranteed loans are made to institutional lenders in the area. Further information on the FMHA home loan program may be obtained from the FMHA, U.S. Department of Agriculture, Washington, D.C. 20250.

K. Secondary Financing.

Secondary financing, such as a second mortgage, refers to a loan secured by a mortgage that is subordinate or junior in priority to a first or primary mortgage loan. The terms "primary" and "secondary" when used in connection with mortgage loans refer to the priority of the lien against the property securing the loan. Thus, a second mortgage, as its name implies, is a lien on property that is junior in position behind an existing first mortgage. A second mortgage allows a buyer to assume a seller's existing mortgage (provided it is assumable) when there is a substantial gap between the outstanding balance of the existing mortgage and the selling price. Even when new first mortgage financing is obtained, a second mortgage can be used to cover any additional financing required. Because of the second mortgage's lower priority, the risk to the lender is greater than with a first mortgage. Consequently, the interest rate is usually somewhat higher

and the loan term shorter than that of a first mortgage. Generally, the terms of second mortgages range from 3 to 12 years and are repaid either by fully amortizing monthly payments or by partially amortizing payments with a lump sum (i.e., balloon) payment at maturity. If the balloon payment is substantial, it is usually contemplated that the buyer will obtain refinancing from a new source. The source of second mortgage financing may be a financial institution or even individuals, particularly the sellers of homes. Although regulated lenders, such as banks and savings and loan associations, traditionally have been subject to various restrictions on secondary financing, these restrictions have been significantly liberalized in the past year.

1. Wrap-Around Mortgage.

The wrap-around mortgage is a form of second mortgage that has been used in times of high interest rates. It differs from the usual second mortgage in that, instead of writing a second mortgage in the amount of the additional financing, the instrument is written in the amount of the first mortgage plus the second mortgage. Thus, the second mortgage wraps around the first mortgage. The term of the second mortgage is usually the same as that of the existing mortgage. The following illustrates how a wrap-around mortgage works: Assume that there is an existing, assumable, first mortgage on the property of $50,000 and that secondary financing of $30,000 is needed to complete a transaction. The traditional method of secondary financing would be to place a $30,000 second mortgage on the property and have the borrower make payments on both mortgages. Using a wrap-around mortgage instead, the second mortgage would be for $80,000 (the amount of both the first and second mortgages) and would provide for monthly payments to the second or wrap-around mortgagee of an amount sufficient to make payments on both mortgages. The second mortgagee, in turn, would be responsible for making the payments on the first mortgage. The interest rate on the second mortgage will be considerably higher than the rate on the existing first mortgage, but somewhat less than the going market rate for first mortgages. The advantage of a wrap-around mortgage to the lender is a higher yield with the least amount of cash investment. The benefit to the borrower is a lower than market interest rate. It should be recognized that financing involving the use of wrap-around mortgages are complex and must be carefully worked out. Appropriate safeguards must be included in the implementing legal documents. Additionally, wrap-around mortgages may violate due-on-sale clauses in the existing, first mortgage. Home buyers and sellers should obtain the advice and assistance of an attorney before entering into such a financing arrangement.

2. Seller Financing.

In times of high interest rates, seller financing has long been a popular tool in facilitating the sale of a home. Homeowners can assist in the sale of their homes by taking back a second mortgage for a portion of the purchase price. They may even take back a first mortgage for all of the necessary financing in instances where their homes are free of a mortgage debt. Second mortgage financing by sellers is a relatively safe investment if sufficient cash down payments are obtained and if the buyers are creditworthy. Terms of such second mortgages are usually tailored to meet the needs of the parties. Seller assisted financing may also take the form of land contracts and buy-down financing, described later.

3. FNMA Home Seller Loan Program.

In those transactions in which the seller provides all of the first mortgage financing, FNMA has established a program under which it will buy the mortgage, thus creating a dependable secondary market for such loans. To qualify for purchase by FNMA, the loans must meet a number of requirements, including the following: (i) the loan must be written on FNMA's standard documents; (ii) the borrower's credit and the property offered as security must meet FNMA's requirements; (iii) the maximum loan amount is $98,500; (iv) the minimum down payment is 5% and private mortgage insurance must be obtained on mortgages with loan-to-value ratios above 80%; (v) the mortgage must be fully amortized over the terms of the loan (not to exceed 30 years) by level monthly payments, including taxes and insurance; and (vi) the loan must be serviced by a FNMA-approved financial institution. The FNMA will purchase such qualifying mortgages upon request of the mortgage holder. The price that the FNMA will pay for the mortgage will depend on the then current mortgage market rates. Further details on FNMA's Home Seller Loan Program may be obtained from FHMA, 3900 Wisconsin Avenue, Washington, D.C. 20016.

4. Land Contract.

Another method of seller financing is the sale of a home through a land contract or installment sales contract. Under this arrangement, the buyer and seller sign a contract calling for the buyer to make a down payment (5%-20%) and pay the balance of the purchase price through monthly installment payments of principal and interest for a stated number of years. (The buyer also agrees to pay property taxes and hazard insurance premiums.) Although the buyer takes possession, the seller retains legal title to the property. (The buyer is deemed to have an equitable ownership in the property.) Legal title is conveyed when the buyer has paid all or a specified portion of the purchase price. Usually, the buyer is required to complete his payments within a short period (3 to 5 years) by obtaining permanent financing from an institutional lender. Land contracts are potentially dangerous arrangements, and many states have enacted laws that regulate their use. Parties to a contemplated land contract arrangement, and in particular buyers, should seek the assistance of counsel before entering into such a transaction.

5. Buy-down Financing.

This financing technique is frequently used by builders in the sale of new homes, although it can also be employed by individual sellers of existing homes. In this type of financing, the builder contributes cash to the lender in order to give the new home buyer a monthly payment rate below market rates during the early years of the loan. Thus, in effect, "buy-down" financing is a mortgage at a reduced interest rate through a lump sum, advance payment of interest by the builder or seller. The reduced rate usually extends for a period of 2 to 5 years. Home builders or developers who advertise the availability of mortgage money at below-market rates usually have arranged in advance with lenders to buy down their home purchasers' monthly mortgage payment. Generally, but not always, the buy-down or subsidy is tacked onto the selling price of the home. While buy-down financing by builders has been fairly common, it is now being considered by individual home sellers as a means of selling their homes

during periods of high interest rates. The use of buy-down financing has been facilitated by FNMA's willingness to purchase such mortgage instruments. The FNMA will purchase buy-downs when the mortgage-rate subsidy is no more than three percentage points and the subsidy period is for no more than five years.

VII. ALTERNATIVE MORTGAGE INSTRUMENTS.

Although the traditional fixed rate/level payment mortgage is still available from many lenders, a number of alternative mortgages are now being offered with greater frequency. The increasing use of these alternative mortgage instruments is principally the result of inflation and high interest rates. Continuing inflation will no doubt enhance their acceptability to home buyers. These instruments are designed for different purposes. Some vary the interest rate so as to increase the yield to the lender. Some restructure the monthly payments to meet the borrower's financial capability. Others are designed for older homeowners, and still others combine two or more of these variables. The basic features of these innovative instruments are explained below. However, it should be noted that these instruments are relatively new and the terms are likely to vary among lenders. Some have technical problems that still need to be resolved. Most have not yet gained widespread acceptance, particularly in the secondary mortgage market. Some regulated lenders are not yet permitted to use a number of these instruments. They are also not authorized for use in connection with FHA or VA financing, except for FHA's graduated payment mortgage program.

It should also be noted that all of these instruments present the risk, if not the likelihood, of a higher overall cost for financing as compared to a fixed-rate standard mortgage. Accordingly, a prospective borrower should understand fully the mechanics of these instruments and the terms involved. Before accepting any such alternative financing, he should weigh the compatibility of the instrument with his needs, capabilities, and future plans.

A. Adjustable Rate Mortgage (ARM).

These instruments come in many different forms and go by many names. The common characteristic of these mortgages is that their interest rates will move up or down, within stated limits, over the term of the loan. The periodic change in the interest rate will be implemented by adjustments in the monthly mortgage payments or to the loan maturity, or by a combination of both. As inducements to encourage the acceptability of these instruments, many lenders offer initial interest rates below the prevailing market rate. Lenders also usually permit assumptions and impose no prepayment penalties or reduced penalties. More recently, leaders have begun offering ARMs which can be converted to a fixed-rate mortgage for a one-time fee. This conversion can normally be accomplished on the loan anniversary during its early years. The fixed rate, however, will be slightly above the prevailing market rate at the time of conversion.

B. Variable Rate Mortgage (VRM).

This is a long-term mortgage where the interest rate varies during the term of the loan based on a standard indicator. The indicator will be some referenced index that reflects changes in market rates of interest. Interest rate adjustments are made at periodic intervals, which could

be monthly, semi-annually, annually, or from every two to five years. Thus, if the index falls, the lender would reduce the interest rate and the monthly mortgage payment would be reduced accordingly. If the index rises, the lender could increase the interest rate and, depending on the terms of the mortgage, the borrower would have the option of either extending the maturity of the loan to keep the monthly payments constant (fixed payment-variable maturity), or paying an increased monthly payment (variable payment-fixed maturity). If the borrower chose to keep his monthly payments constant, then the extra interest owed as a result of an increase in the index would be added to the loan balance and the life of the loan would be extended until the extra interest was paid off. For example, the home buyer might initially take out a 35-year loan which would be amortized over 30 years. The monthly payments for the 30 years would remain constant. If any additional interest were owed because of higher interest rates during the 30 years, it would be paid off during the subsequent five years. Both the Federal Home Loan Bank Board (FHLLB) (which regulates federal savings and loan associations) and the Comptroller of the Currency (which regulates national banks) have issued regulations authorizing these lending institutions to make variable rate mortgage loans and establishing certain limits. Under both rules, interest rate changes must be linked to an external index, which may be the rates on three-month to five-year Treasury securities, the FHLBB's index of mortgage rates, or the average borrowing rate of the FHLBB's regional banks. Under the FHLBB's current rules, savings and loan associations may adjust the interest rate as frequently as every month with no limit on the rate increases. Under the Comptroller's rules, banks may adjust the rate at no more frequent intervals than six months and the rate change (up or down) may not be more than two percentage points per year. Neither imposes any overall limits on how much the interest rate can change during the life of the loan. These rules, of course, only set limits. Lenders will establish their own exact lending terms. In assessing the terms of a VRM, a borrower should consider the following: (1) The initial interest rate. How does it compare to the prevailing market rate? (2) The index to be used. Some (e.g., the prime rate) are more volatile than others. The index should be one that is generally available to the public and beyond the direct control of the lender. (3) The frequency of the periodic rate adjustment (monthly, semi-annually, etc.). The longer the intervals, the greater the stability in the monthly payments. (4) The method of computing an adjustment and the amount of change required in the index to trigger an adjustment. (5) The limits, if any, on the maximum amount of adjustment permitted at periodic intervals and for the life of the loan. (6) Options available for implementing an adjustment. (Variable payment/fixed maturity or fixed payment/variable maturity). (7) Loan assumption and prepayment penalties.

C. Renegotiable Rate Mortgage (RRM).

This is a variation of the VRM; but instead of adjusting the interest rate at periodic intervals, it provides for the renegotiation of the interest rate after a longer fixed term cycle of three, five, or seven years. At the end of the term, the rate is renegotiated to reflect the then-current market rate. In effect, an RRM is a series of renewable short-term loans secured by a single long-term mortgage of up to 30 years. Another version of the RRM is the so-called Rollover Mortgage. It differs from an RRM in that at the end of the term (e.g., five years) the loan becomes due and is replaced by another short-term loan at the then-current interest rate. It also differs in that the loan may be renewable at the option of the borrower or lender.

D. Deferred Payments Mortgages.

These mortgage instruments are designed to assist borrowers by restructuring the payment requirements to meet their financial capabilities. Some also combine the adjustable interest features discussed above.

E. Graduated Payment Mortgage (GPM).

This instrument is characterized by lower monthly payments at the beginning, increases in stages for a period of years (5 to 10 years), and then a leveling out so as to achieve full amortization of the loan. The graduation rate, the term or stages of graduation, and the interest rate are fixed for the life of the loan, which customarily is 25 to 30 years. Several variations of the GPM exist. For example, the stages of graduations can vary from a single increase to an increase with every monthly payment. (See discussion at page 141 on FHA's Section 245 GPM program.) The GPM is most appropriate for younger, upwardly mobile home buyers or first-time home buyers who expect increasing incomes. It is also attractive in times of expected continuous inflation. The obvious drawback to a GPM is the borrower's difficulty in meeting future increasing payments if his income fails to rise as anticipated. The graduation rate is also an important factor to consider. It determines how rapidly payments will increase each period and the amount of negative amortization, if any, that may occur during the graduation stage. (Negative amortization occurs when monthly payments during the graduation stage are less than the accruing interest, thus increasing the balance of the loan by the amount of the difference.) The amount of negative amortization may influence down payment requirements. Lenders may require a larger down payment in order to minimize the risk associated with the negative amortization.

F. Graduated Payment Variable Rate Mortgage.

This instrument is essentially a GPM which uses a variable rather than a fixed rate of interest. It incorporates the features of a GPM of low initial and gradually increasing payments and the features of a VRM through the use of a variable interest rate. The borrower's payments rise at a prearranged rate throughout the life of the loan, but the actual interest rate charged to the borrower varies with the movement of the referenced index. The maturity of the loan is then adjusted (forward or backward) to reflect interest rate changes during the course of the loan.

G. Deferred Interest Mortgage.

As its name implies, this mortgage instrument simply defers the payment of a portion of the accruing interest for a specified period (3 to 5 years). The accumulated deferred interest is payable together with a fee at the end of the deferral period. The loan may be renegotiated at the end of the deferral period to incorporate the amount of deferred interest in the principal of the new loan. This type of instrument may be particularly attractive in areas where homes are appreciating rapidly in value and where borrowers expect to sell their homes by the end of the interest deferral period.

H. Pledged Account Mortgage.

This financing instrument is sometimes referred to as the Flexible Loan Insurance Program or FLIP since one of its early developers was the FLIP Mortgage Corporation. It has attributes of a GPM in that it provides for lower but graduating payments during a specified period followed by level payments for the life of the loan. It differs in that the graduating payments are supplemented by monthly payments from a pledged, interest-bearing account established by the borrower from a portion of the loan proceeds. For illustrative purposes, assume that a home is to be purchased for $70,000 and that the buyer is to make a $7,000 down payment and obtain financing for the balance of the purchase price. Instead of lending $63,000, the lender will actually loan $70,000, or perhaps slightly less. The extra $7,000 is placed in an interest-bearing account with the lender and is pledged by the borrower as additional security for the loan and as a source of supplemental payments during the first few years of the loan. Each month, the lender withdraws a predetermined amount from the pledged account which, when added to the borrower's reduced monthly payment, makes a full, normal mortgage payment. The supplemental payment continues until the account is depleted at which time the borrower's monthly payment will have graduated to a level to fully amortize the loan. The advantages of this instrument are that the borrower's early monthly payments could be as much as 25% to 30% lower as compared to a standard mortgage. Also, if the borrower is able to place additional funds in the pledged account from his own resources, he may be able to qualify for a much larger loan and thus be able to buy a more expensive home.

I. Shared Appreciation Mortgage (SAM).

This instrument, also known as an equity participation loan, involves a long-term loan made at a substantially lower interest rate in return for a percentage share of the future appreciation of the property. For example, a typical SAM might provide for an interest rate one-third below the prevailing market rate in exchange for the homeowner's agreement to pay the lender one-third of the home's appreciation when the home is sold or after a specified time, generally 5 or 10 years. Thus, if a home with an initial value of $40,000 is subsequently sold at $70,000, the lender would be entitled to $10,000 (1/3 of $30,000) as its share of the appreciation. If the home is not sold within the specified time, the house would be reappraised at such time (5 or 10 years) and the borrower would then pay to the lender an amount equal to one-third of the increase in value of the property. This amount would be payable in cash or by the making of an additional loan in such amount. Generally, this loan would be at the original interest rate and amortized over the same period as the original loan. The amount the lender receives as shared appreciation is considered as payment of deferred interest. Because of the variables involved in a SAM, it is not possible to assess at the outset the true interest cost of such an instrument. Theoretically, the greater the appreciation and the longer the house is held, the greater will be the actual interest cost. For these reasons, a SAM instrument is likely to be more attractive for homeowners who expect to sell within five years after purchasing the property.

J. Reverse Annuity Mortgage (RAM).

This instrument is designed for older or retired homeowners who have a low mortgage, or none, on their homes. It is not used to finance the purchase of a home. In effect, this form of mortgage loan enables such elderly homeowners to convert their home equity into a supplemental monthly income without having to sell their homes. Although the basics of this financing technique are still being refined, a variety of forms have been developed. In addition, such loans are now governed by federal law and regulation and can be sold in the secondary market if they meet federal requirements. This has increased their viability and usefuleness. The simplest form is the "rising-debt" version, in which the loan proceeds are paid to the borrower in the form of an annuity (i.e., monthly payments for the life of the loan) so that an increasing indebtedness (consisting of principal and interest) is generated over time. The indebtedness is payable upon the sale of the home, the death of the borrower, or at some specified date, whichever first occurs. At the conclusion of the term, the lender could refinance all or part of the indebtedness through a similar mortgage instrument. Another possible form is a fixed-debt loan with the procurement of a separate life annuity. Under this form, the lender disburses the entire loan proceeds to the borrower, who, in turn, purchases a whole life annuity. Interest is paid currently, but the repayment of principal is deferred until the borrower's death or sale of the home.

VIII. CLOSING - THE SETTLEMENT PROCESS.

Settlement or closing is the consummation of the real estate transaction. It is the formal event where the seller conveys title (by delivering an executed deed) to the property and the buyer makes payment in accordance with the terms of the sales contract. It is held on the date agreed to by the parties which is usually set forth in the same contract. The settlement is conducted by a person designated to be the settlement or closing agent. In some areas, the agent may be the lender, a real estate broker, an escrow company, or an attorney. In other areas, it is common for a title company to serve as closing agent. Settlement procedures also differ throughout the country. In some areas, all of the parties or their representatives attend the settlement. In other jurisdictions, the settlement may take place without the presence of the parties. Instead, all documents are executed by the parties in advance and submitted to the settlement agent together with all funds. The agent holds all documents and funds in escrow and consummates the closing on the appointed date. While settlement procedures may differ throughout the country, the tasks involved are essentially the same. Some uniformity in conducting settlements has resulted from the Real Estate Settlement Procedures Act (RESPA), particularly with respect to the required use of a uniform settlement statement for all transactions that are subject to the RESPA. Additional uniformity also now exists with respect to documents as a result of FHA, VA, and FNMA requirements.

A. Pre-Closing Matters.

After a sales contract has been signed, there are a number of tasks that must be performed before the parties can proceed to a closing. Typically, financing arrangements must be completed, a title search must be conducted, legal documents (deeds, mortgage, etc.) must be

prepared, and hazard insurance must be obtained. In addition, there may be a need for a survey, property appraisal, and home and termite inspections. The buyer must notify the various public utilities (gas, electricity, telephone, and water) in advance and arrange to have these services in operation to the premises in his name effective on the closing date. The seller must also instruct the utilities to discontinue service under his account as of the closing date. The buyer must be prepared to have the cash funds required at the closing. This includes the remaining down payment toward the purchase price and the closing costs, including prepaid items that are charged to the buyer. Under the RESPA, the lender is required to furnish a good faith estimate of the closing costs that the buyer is likely to incur. Shortly before the closing, the settlement agent should provide the buyer with the exact amount required at closing. The buyer should bring a certified check to the closing in the proper amount. (It is wise to bring an additional blank check to the closing in the event of an unexpected, last minute, minor adjustment in closing costs.)

B. Closing Documents.

The various documents that will be exchanged at the closing depends upon the provisions of the sales contract and the requirements of the lender. The closing agent will receive instructions from the lender as to the documents required before loan funds may be dispersed.

1. Deed.

The seller will execute and deliver a deed which conveys title to the property to the buyer. The deed should contain such covenants as required by the sales contract. The legal description in the deed should also be reviewed to assure that it conforms to the property being sold. If there is more than one buyer, the deed will also set forth the basis upon which the buyers will take title - that is, as tenants in common, joint tenants, or, in the case of husband and wife, as tenants by the entirety.

2. Promissory Note.

If the buyer is obtaining financing for a portion of the purchase price, he will execute a promissory note in the amount of the financing. The note will also set forth the interest rate and the repayment terms.

3. Mortgage or Deed of Trust.

The buyer will execute a mortgage in favor of the lender which grants a lien or security interest in the mortgaged property to secure the repayment of the loan. In some areas, a deed of trust is used instead of a mortgage. It serves the same purpose and has the same effect as a mortgage. The mortgage (and sometimes the note as well) will usually require that the borrower pay an additional fractional amount each month with his mortgage payment to cover the annual real estate taxes and hazard insurance premiums on the property. These payments will be placed in the borrower's reserve or escrow account. How payments to that account are computed is governed by federal regulations which limit the amount of advance payments.

4. Evidence of Title.

In addition to conveying good title to the property, the seller must also furnish evidence of such good title in accordance with the provisions of the sales contract. There are essentially three methods of establishing evidence of title: (i) abstract and opinion, (ii) attorney's certificate of title, and (iii) title insurance. The sales contract or the lender's requirements will dictate which method is to be used.

5. Fire and Hazard Insurance.

If financing is involved, the lender will normally require that the buyer have a fire insurance policy or binder in force at settlement in an amount not less than the amount of the mortgage loan. The policy (binder) must have a mortgagee endorsement in favor of the lender. Usually, the buyer obtains a new policy. In some cases, however, the seller may assign his existing policy to the buyer. In that event, the seller will be entitled to a pro rata adjustment for any premium already paid.

6. Other Documents.

The seller will be required to furnish such other documents or certificates as may be required by the sales contract. These may include a termite certificate, water and septic certificate, house inspection report, and survey. Additional certificates may be required if FHA or VA financing is involved.

7. Closing Statement.

The closing statement or settlement sheet is the focal point of the closing. It is prepared by the closing agent and sets forth all the payments, costs, and apportionments charged or credited to each party. If the RESPA applies to the transaction, the Uniform Settlement Form (HUD-1) devised by the HUD must be used.

C. Post-Closing.

At the conclusion of the closing, the parties will have reviewed and executed the various documents described above, the buyer will have made all required payments to the closing agent, and the seller will have given the keys to the home to the buyer. (The seller gives possession of the premises to the buyer at settlement if that is the agreement of the parties.) The parties will receive conforming copies of all documents. The closing agent retains all original documents and funds and undertakes to perform the post-closing activities. The closing agent will promptly record the deed and mortgage or deed of trust. He will then make disbursement of funds in accordance with the settlement sheet. It usually takes several days following the closing before disbursement is made. Disbursement may be further delayed if agreement has been made for holding funds in escrow pending the resolution of any issues (e.g., the expiration of time for filing mechanic's liens or repair/completion of minor items).

D. Closing Cost Items.

The closing costs are all the charges and fees associated with transferring ownership of the property and assuring that title is valid, arranging the financing and the security for such financing, and carrying out such other tasks as provided for under the sales contract. The party responsible for these various costs will be determined either by the sales contract, or, in the absence of a controlling provision in the sales contract, the custom and practice of the jurisdiction. The following is an enumeration of typical closing cost items.

1. Costs Related to Obtaining Financing.

a. Origination Fee.

This is the lender's fee charged to the buyer (borrower) to cover administrative costs for originating the loan. In most areas, the fee is 1% of the loan. A larger fee may be charged in conventional loans, but the limit is 1% on FHA and VA loans.

b. Points.

A lender may require additional fees or points in order to improve the rate of return on the loan. (Each point is equal to 1% of the amount of the loan.) The number of points will vary with the lender, the type of loan, and the prevailing conditions of the mortgage money market. On conventional loans, the parties usually agree to share the points charged. On FHA and, until recently, VA loans, the buyers are not permitted to pay points, although they may be charged one point in the form of an origination fee. If the buyer is assuming the seller's existing loan, the lender may charge an assumption fee to the buyer in accordance with the provisions of the existing mortgage.

c. Credit and Appraisal Reports.

The lender will usually require an appraisal of the property and a report on the buyer's credit. These costs are usually charged to the buyer.

d. Private Mortgage Insurance (PMI).

In a conventional loan, if PMI is required, the buyer will pay at least a portion of the premium at closing. For VA loans, a funding fee, similar to PMI, is required based on the amount of the down payment. For details, see page 1-39.

e. Prepaid Items.

The lender will require the buyer to establish a reserve or escrow account with the lender to cover the future payment of such recurring costs as real estate taxes and hazard and mortgage insurance premiums. At the closing, the buyer will usually be required to pay into the account an amount sufficient to cover these costs for several months in order to assure that funds will be available to pay these bills as they fall due. The lender then pays the bills from the reserve

account. The RESPA imposes certain limits on the amount of reserve or escrowed funds which may be required by the lender at closing. Generally, this amount is limited to two-twelfths (two months) of the estimated annual costs of such items, plus an additional amount that would normally have been escrowed based on the time then remaining to the annual due date of such costs.

2. Costs Related to Conveyance of Title.

a. Title Search and Examination.

An attorney or title company will search and review the public records to determine the condition of the seller's title. The buyer normally pays this cost.

b. Certificate of Title.

If title insurance is not used, then an attorney's opinion or attorney's certificate of title will be obtained as evidence of seller's good title. This cost is normally paid by the buyer.

c. Title Insurance.

Most lenders now require the issuance of a title insurance policy to protect the lender's lien interest in the property against title defects. Only one premium payment is required and it is due at closing when the policy is issued. The lender's policy does not protect the borrower. A separate owner's policy should be obtained to protect the borrower. The party that pays for title insurance varies with local custom. In the absence of a fair market value rider, title insurance company liability is limited to the selling price of the house.

d. Survey.

Most lenders will require a survey in order to determine the precise location of the house and the property boundaries. It also protects the buyer in that it assures that the property matches the description in the deed. The cost of a survey is normally paid by the buyer.

3. Governmental Fees and Charges.

a. Recording Fees.

All local governments charge fees of various amounts for recording documents (the deed and mortgage) relating to the sale. These costs are normally paid by the buyer.

b. State and Local Transfer Taxes.

Some jurisdictions impose a fee or tax on the transfer of ownership of property. The party that pays this cost varies with local custom. These can be substantial and should be considered in determining sales price.

4. Attorney and Other Professional Fees.

A fee is paid to the attorney who prepares the deed, note and mortgage, and other required documents. Except for the deed, these costs are normally paid by the buyer.

IX. CONDOMINIUMS.

A. Legal Concept and Applicable Law.

Condominium housing is a form of ownership in realty in which a person owns a unit, in fee simple, as well as an undivided interest in the common property and facilities (the "common elements") with other unit owners. In an apartment building condominium, each apartment is a unit. In effect, a unit is a cubicle of air surrounded by the interior walls, ceiling, and floor of a particular apartment. Everything else on the property, including the land, are the common elements. Apartment condominiums can be newly constructed or converted from existing rental property. They may be single-building or multi-building developments. In addition, condominiums can be town house developments and even clusters of detached single family homes. But all housing developments with surrounding community land and facilities are not necessarily condominiums. Some may be planned unit developments (so called PUDs) in which each homeowner has a membership, but not ownership, interest in the community area.

The unit owner has the right to use the common elements with all other unit owners in accordance with the declaration, by-laws, and rules and regulations of the condominium. There may be, however, certain parts of the common elements that are reserved for the exclusive use of a particular unit owner (e.g., assigned parking spaces and balconies adjoining units). These are called limited common elements.

All states have laws which establish the legal framework for the creation of condominiums. In many states, they are referred to as the Horizontal Property Act. In addition, many states have laws that regulate condominium projects and establish various rights and obligations of condominium ownership. There is a Uniform Condominium Act, drafted by the National Conference on Uniform State Laws; but it has been adopted by only three states. Consequently, there is no uniformity to the state statutes; so in analyzing the legal aspects of any condominium, it is important to review the particular state's law. There is no federal law that governs condominiums; however, the HUD has issued a model law that has been adopted by a few states. In addition, some uniformity has resulted from FHA regulations for condominium projects that have been approved for FHA-insured loans. Notwithstanding the lack of uniformity in state laws, there are a great number of features which apply to virtually all condominiums. Many of these features are discussed below.

B. Attributes of Condominium Ownership.

In a sense, a condominium is comparable to a small municipality. In a new condominium project (i.e., newly built or converted), as units are sold, the control of the common elements is eventually transferred from the developer to the unit owners through a condominium owners association, which is usually formed as a nonprofit corporation. Each unit owner is a member of

the association and is entitled to vote as specified in the condominium documents. The association elects a board of directors from among the membership. The board sets policy and oversees the operation of the condominium. (The day-to-day operations may be performed by a professional management company through a contract with the board.) The board is also responsible for the preparation of the budget and the assessment of common charges against the unit owners.

Since each unit of a condominium is individually owned, each unit is also separately financed. A unit owner can obtain a loan secured by a mortgage on his unit. Only his unit and his percentage interest in the common elements are subject to the mortgage lien. Property taxes are also separately assessed on each unit so that if someone does not pay his taxes it will have no effect on other unit owners. Unit owners also pay their own utilities if separately metered; otherwise, utility costs are included in the monthly assessment. Each unit owner is responsible for all maintenance and repairs within his own unit. He also pays for his own hazard insurance on his unit, although in many instances the insurance is obtained through a blanket policy for the entire condominium. All common areas are insured through the association and the cost assessed as part of the monthly fee.

All unit owners are assessed a monthly charge, generally called a condo fee, to cover the common expenses of the condominium. These include the cost of such items as maintenance, repairs, and operation of the common elements; hazard and liability insurance; management fees; and reserves for major repairs, replacements, and contingencies. Unpaid condo fees generally constitute liens on the delinquent units and may be collected through foreclosure action.

A condominium owner has the same income tax advantages as a conventional homeowner. Real estate taxes and interest payments on mortgages are tax deductible items.

C. Condominium Documents.

1. Enabling Declaration or Master Deed.

This is the document that brings the condominium into existence and establishes its structure and organization. It is the recorded legal instrument that defines and precisely describes (with plans and drawings) the individual units and the common elements and specifies the percentage ownership interest of the common elements allocable to each unit. It provides for the establishment of the condominium owner's association and the powers and authorities of the governing body of the association. It may also contain a number of restrictive covenants on the use of the individual units and the operation of the common property. It will also set forth the rights, if any, retained by the developer. Finally, it will describe the requirements for amending the master deed or declaration, which generally requires the affirmative vote of at least 75% of the unit owners.

2. By-Laws.

These are the rules and regulations for the operation of the condominium. They are usually recorded as an attachment to the master deed and are binding on all unit owners. Some of the items normally included in the by-laws are as follows:

- Rules of conduct and prohibited activities.
- Restrictions on use of or alterations of the units.
- Association meetings and election of the board of directors.
- Insurance matters.
- Use and maintenance of the common elements.
- Provision for professional management.
- Books and records.
- Procedures to amend the by-laws (generally requiring only a majority of the unit owners).

Some of the items listed above may appear in the master deed instead of the by-laws. If so, then a higher percentage of the affirmative vote of the unit owners is required to amend that provision. Condominiums may also have additional rules or guidelines adopted by the board that are designed to control the conduct of unit owners. They may regulate such matters as trash removal, noise, behavior of children, pets, parking, deliveries, outdoor cooking, and use of terraces and balconies.

In order to maintain a high level of home ownership (i.e., owner-occupied units), it is not uncommon for the condominium documents to contain a provision that restricts or limits the renting of a unit by its owner. The documents may also provide that the owner's association has the right of first refusal in the sale of a unit by an owner. This means that a unit owner must offer to sell the unit to the association before it can be sold to another person. Such a requirement is used as a means of preventing a sale of a unit to a person who may be financially incapable of paying the monthly condominium assessments.

3. Unit Deed.

As in the case of the purchase of conventional housing, the ownership of a condominium unit is conveyed to a purchaser by a unit deed. The deed will make reference to the master deed and give the legal description of the unit. The deed also conveys the undivided interest in the common elements allocable to the unit. Unit deeds are customarily recorded following a closing. The type of deed is that which is customarily used in the locale, but typically it is a general warranty deed.

4. Sales Contract (Subscription and Purchase Agreement).

The sales agreement is similar to that used in the purchase of conventional residential housing. There are, however, some provisions that are peculiar to the purchase of a condominium. For example, the agreement will reference and incorporate the master deed and by-laws for the condominium. (Copies of these documents are either attached to the agreement or provided to the purchaser.) The agreement will also provide that the purchaser accepts or ratifies these documents. In new, or existing newly converted, condominiums, the agreement

may provide that the developer may cancel the agreement if a certain percentage (usually 75-80%) of the units are not sold by a prescribed date.

In some instances, the agreement may contain a so-called cooling off provision which grants the purchaser the right to cancel the agreement within five days of signing.

5. Prospectus (Information Bulletin).

A number of states require that a developer furnish each prospective purchaser with an information bulletin which discloses pertinent facts concerning the condominium. In general, it includes such items as estimated costs of maintenance, taxes, management fees, settlement costs, reserve funds, and any other significant features of the condominium.

6. Regulatory Agreement.

A regulatory agreement is required for condominium projects that are approved for FHA financing. It is an agreement between the FHA and the condominium owner's association which establishes certain requirements that must be met by the association to qualify the project for FHA-insured mortgages. Although this agreement is intended to protect FHA's mortgage insurance risk, it has the added benefit of protecting unit owners by facilitating the successful operation of the condominium. The agreement requires the establishment of a reserve fund to replace structural items and equipment, such as roofs, heating and cooling system, etc. It also requires a contingency operating fund to serve as a financial cushion in the event the condominium's current operating expenses exceed monthly fees.

D. Financing.

Condominium units are financed in much the same manner as conventional housing. Although there are government-insured loan programs, conventional loans are the predominate means of financing the purchase of condominium units. National banks and federal savings and loan associations are authorized to make condominium loans.

At the outset, a condominium project is financed in two phases. First, the construction or the conversion and rehabilitation phase is financed through a project or blanket mortgage loan obtained by the developer. As units of the project are sold to individual owners, the units are released from the blanket mortgage and financed separately, with such financing secured by mortgages on the units. In most cases, a developer will have arranged for the financing of units, frequently with the same institutional lender that provided the project loan. The purchaser then has the option of accepting such financing, provided he qualifies, or seeking a loan from another source if he thinks he can get better terms. When a condominium unit is subsequently resold by a unit owner, the new purchaser must arrange for his own financing in essentially the same manner as on the resale of a conventional home.

FHA financing is available for condominium housing under Section 234 of the National Housing Act (12 U.S.C. § 1715y). The amount and terms of such FHA-insured unit loans are similar to those for conventional housing insured under section 203. Graduated payment mortgages are authorized. However, if a condominium project consists of 12 or more units, the

units are eligible for FHA financing only if the condominium project has been covered by a blanket or project mortgage insured by the FHA. Although this financing requirement does not apply to condominium projects of less than 12 units, even in such smaller-unit projects, the condominium documents must conform to FHA standards before such units are eligible for FHA financing. These requirements have tended to restrict the use of FHA-insured loans for the financing of condominium units. An FHA field office should be consulted to determine the eligibility status of a particular condominium project. Severe limits are placed on FHA funding of condominium conversions, however. These limits restrict non-tenant organizations from converting rental property to condominiums at government expense.

Condominium units are eligible for VA-guaranteed loans on essentially the same terms and requirements as for VA financing on conventional family housing. However, the VA will grant a loan guarantee only if the FHA has insured at least one unit in the condominium project. Accordingly, prospective purchasers of units in conventionally financed projects should be aware that if they subsequently wish to sell their units, FHA or VA financing will most likely not be available to their purchasers.

Although most condominium units are financed through conventional mortgage loans, some institutional lenders may be unwilling to make condominium loans unless they are assured that the loans are readily disposable in the secondary mortgage market. To facilitate the acceptance of these loans in the secondary market, the FNMA has established a program whereby it will review and certify a condominium project if it is found to be financially and legally sound. If the project is certified, then the FNMA will purchase a unit loan if the loan is offered for sale by the lender. A condition to certification imposed by the FNMA is that the units in the project be substantially owner occupied. For new condominium projects, this generally means that 80% must be owner occupied. For projects over two years, at least 60% must be occupied by unit owners as their primary year-round residence. Accordingly, for purposes of facilitating the subsequent resale of an unit, it may be important to a unit owner that his condominium meet these owner-occupied ratios in order for his purchaser to be able to obtain conventional financing from institutional lenders.

E. Evaluating a Condominium.

In determining whether to buy a condominium unit, the prospective purchaser should carefully review the condominium documents. In addition, the factors or matters listed in the checklist in Chapter 2 should be considered in assessing the soundness of the condominium project and its suitability to the purchaser.

These factors are relevant and should be carefully considered whether the unit is in a newly constructed condominium or a rental conversion, or whether it is to be purchased from a developer or by resale from an individual unit owner.

X. COOPERATIVES.

In addition to the condominium, the other principal form of joint ownership of a multi-unit dwelling is the stock cooperative or cooperative. A cooperative is established as a corporation which holds title to all of the property in the project. A member of the cooperative

owns stock in the corporation which carries with it the exclusive right to occupy a unit in the project. Each share member signs an occupancy agreement with the corporation.

Unlike condominiums, cooperatives are financed through a blanket loan in which the corporation is the borrower or mortgagor. The corporation is directly responsible for the payment of the mortgage (principal and interest), taxes, and all other costs and expenses in the operation of the cooperative. Each member makes monthly payments to the corporation to cover his pro rata share of all costs, including the mortgage and taxes. Each member is allowed a tax deduction for his share of the interest and taxes paid by the corporation. The corporation is governed by a board of directors elected by the members of the cooperative.

Separate loans to individuals for the purchase of an interest (i.e., shares of stock) in a cooperative are made by commercial banks and savings and loan associations. The stock purchased serves as security for such loans. The FHA is authorized to finance cooperative projects under Section 213 of the National Housing Act (12 U.S.C. § 1715e). However, except for low-cost housing projects, the FHA is not a significant source of cooperative financing. The VA is not an active source.

The major economic drawback of a cooperative is its permanent financing through a blanket mortgage. If a member defaults in his payments, the other members must make up the difference. Because of such financial interdependence, the cooperative by-laws usually impose restrictions on the sale of a member's stock in the cooperative. Sales of stock interest usually require the approval of the board of directors, which is granted only upon receipt of a favorable credit and background report on the new purchaser. This financial interdependency, together with the restrictions on the transfer of member shares, frequently results in rendering the share marginally acceptable as security for financing resales of cooperative units. Consequently, on such resales, purchasers are usually required to make substantial cash down payments in order to buy out the seller's built-up equity interest in the cooperative.

The checklist for evaluating a cooperative is essentially the same as for a condominium project.

XI. PURCHASE OF UNDEVELOPED LOTS.

The past decade has seen a phenomenal growth in promotional land sales operations. Generally, such operations involve the sale of unimproved land or lots in developments in distant locations. Inevitably, these lots are promoted as future retirement sites, second houses, recreation or vacation retreats, or campsites. While many of these developments are probably fair, reliable, and honest operations, a number of them, unfortunately, have involved consumer abuse and misrepresentation or have failed due to inadequate financing. The promotional practice that is most troublesome usually involves the purchase of a lot based on a colorful brochure showing what is planned for the area and claiming that purchasers acting promptly have an opportunity to get in on the ground floor at a price which is certain to double or triple in a few years.

The potential for abuse or lack of buyer protection occurs when lots are purchased on long-term contracts (or land contract) instead of by immediate conveyance of ownership of the lot to the purchaser with mortgage financing for the balance due on the purchase price. A typical

long-term contract may provide for the purchaser to make payments to the development corporation for a number of years, at which time the corporation agrees to convey the lot to the buyer or, if it is unable to give the buyer a clear deed to the lot at the end of that time, to return the buyer's money. The corporation may further promise that at such future time it will have constructed and installed the necessary roads and essential utility services. The contract may provide that the purchaser is obligated for the full purchase price or it may simply provide that, upon default, the buyer forfeits everything paid to date as liquidated damages. The contracts are generally nonrecordable. The following illustrate some of the problems that may occur from such contractual arrangements.

The buyer knows very little as to the financial condition of the corporation to which he is to pay several thousand dollars over a period of five to ten years; and, during this period, he has no security for the payments made. Even if the corporation issues a valid bond insuring the return of the buyer's money if the corporation is later unable to convey good title at the agreed time, it has had the free use of the money for five to ten years. Since the corporation will not give a recordable deed and take back a mortgage for the balance due on the purchase price, the buyer is not certain he owns anything except a contract right against a corporation of questionable solvency. If during the intervening years the development is unsuccessful, any assets which the corporation might have will probably have been dissipated long before the buyer is able to reduce his claim to a judgment. On obtaining a judgment, he is likely to find the corporation insolvent and the judgment uncollectible.

The buyer agrees to purchase a lot located far from existing streets and utility services. The lot will not be a suitable site for a dwelling until such streets and utility services are completed, and they are not likely to be completed unless the promotion is a long-term success. A buyer who fails to inspect property before buying may find it located in swamp land or desert.

If the contract is not recordable, the buyer's rights to the lot could be extinguished by a subsequent purchaser who has no knowledge of the first contract, or by a judgment creditor of the party who holds the recorded title (which may or may not be the development corporation).

These potential problems can be minimized, if not eliminated, if purchasers make prior on-site inspection of the lot, buy in areas where streets and utilities are in place, and get a deed to the lot at the time of purchase. In addition, they should be assured that they are getting a marketable title (e.g., title insurance or an attorney's opinion). If a lot purchaser is already committed to a contract such as that discussed above, he should contact his legal assistance attorney and discuss possible alternatives for protecting, or perhaps even abandoning his investment. For example, it may be possible to exchange a lot in the wilderness for one located in the nearer reaches of the development where streets and utilities are already in place and where homes have been built. The buyer might also be able to successfully negotiate for a deed to the lot on revised payment terms.

A number of states have enacted laws that offer a measure of protection against fraudulent sales operations. At the federal level, the Interstate Land Sales Full Disclosure Act also offers a measure of protection by requiring certain disclosures be made to prospective buyers of unimproved lots in development projects that are subject to the Act. (Under certain circumstances, condominium developments may also be subject to the Act.)

The Interstate Land Sales Full Disclosure Act (15 U.S.C. § 1701 *et seq.*) requires a developer, whose project is subject to the Act, to file a "statement of record" with the HUD. The statement is available for public inspection and must be in effect before any lots can be sold. The statement must include the developer corporation's financial statements, corporate documents, and history of the company, including its principal officers and owners. The statement must also include information on such items as a description of the development, condition and title ownership of the land, availability of utilities, plans for streets and recreation areas, local laws and taxes, and selling terms and arrangements.

The Act also requires the developer to prepare a "property report" which must be given to a prospective purchaser before he signs a contract. If the report is given less than 48 hours before execution of the contract, the buyer has the right to rescind the contract until midnight of the third day following consummation of the transaction. The property report is essentially a condensation of the statement of record and is presented in question-and-answer form. If the statement of record and property report contain misstatements of fact or omissions, or if fraudulent sales practices are used, a purchaser can sue for damages.

It should be noted that a number of promotional land sales operations are exempt from the Act. If a development is exempted, then a statement of record is not filed with the HUD and a property report need not be given to prospective buyers. Some of the major exemptions are the following: (i) developments with less than 25 lots which are not sold pursuant to a common promotional sales plan; (ii) developments in which all lots are twenty or more acres in size; (iii) lots upon which a building has been erected, or where the sales contract obligates the developer to build one within two years; and (iv) lots sold on site, free and clear of liens. There are also a number of other exemptions provided for by statute or by HUD regulations.

It is important to remember that, even with respect to developments subject to the Act, HUD does not inspect the lots or verify the information in property reports. HUD's Office of Interstate Land Sales Registration (OILSR) will assist purchasers to secure the rights given to them under the Act.

OILSR recommends that a prospective buyer consider the following before signing a contract:

1. Will you receive a deed upon purchase or a recordable sales contract? Will you have clear title to the property? What liens, reservations, or encumbrances exist?

2. How large will the development become? What zoning controls are specified?

3. What amenities are promised - club house, swimming pool, or fishing lake? Are there extra charges for using these facilities? What provision has the developer made to assure construction and maintenance? Has he set aside money in a special (escrow) account and committed the funds to pay for these extra items?

4. What are the provisions for sewer and water service? For garbage and trash collection? Other utilities?

5. If funds are placed in a special account earmarked for a sewage treatment plant or other facility, how soon will the administering authority be formed? Who will be members of the authority? When will construction start and when will the facility be in operation?

6. Will there be access roads or streets to the property and how will they be surfaced? Who maintains them? How much will they cost?

7. What happens to the buyer's payments? Are they placed in a special escrow account to pay for the property or are they spent at once by the developer?

8. If the developer defaults on his mortgage or goes bankrupt, could you lose your lot and your investment?

9. What happens when the developer moves out? Is there a homeowners' association to take over community management? If so, what is expected of you as a member?

10. Waterfront lots on man-made lakes present special potential problems. Is the lake completed? How many lot-buying families will use it? Who maintains the dam and pays insurance on it? How is the lake kept free of sewage and other pollution?

11. Are there restrictions against using the lot for a campsite until you are ready to build?

12. Are there any annual maintenance fees or special assessments required of property owners? Do those fees commence immediately, even though you will not build on your lot or use it for years?

This, of course, is not a complete list. Prospective purchasers will no doubt have other items they will want to consider. Most importantly, always make an on-site inspection.

XII. INCOME TAX CONSEQUENCES OF HOME OWNERSHIP.

Home ownership has a number of income tax implications. The following is a brief description of the tax consequences that may result from the purchase or sale of a home and of the various tax deductions available to a homeowner. For additional information, *see* IRS PUBLICATION NO. 17, YOUR FEDERAL INCOME TAX.

The Internal Revenue Code requires taxpayers to possess records sufficient to support their tax returns. The law does not require any special form of records. Taxpayers must, however, have written documentation (e.g., receipts, invoices, canceled checks, etc.) to prove all deductions and credits appearing on their returns. Records must be kept until the statute of limitations expires for the particular tax return. Usually, this is three years from the date the return was due or filed. However, certain records with respect to home ownership must be kept for a longer period. For example, in a sale of a home, or in the purchase of a replacement home, the tax consequence depends on the basis of the home that was sold. It is important, therefore, to keep records of all transactions that affect the basis of the property.

A. Tax Deductions and Credits for the Homeowner.

1. Real Estate Taxes.

State and local taxes on real property are deductible as itemized deductions in the year paid. If paid into an escrow account with your mortgage payment, only actual taxes paid from the escrow account during the tax year are deductible.

2. Interest.

The interest portion of mortgage payments are deductible as itemized deductions in the year paid. The amount of interest paid during the year can be obtained from the lender. Prepayment penalties for paying off a mortgage before it comes due are also deductible as interest payments. A tenant-stockholder in a cooperative apartment house may deduct his share of the interest paid on the cooperative's mortgage.

3. Casualty Losses.

Damages to a residence as a result of fire, flood, hurricane, vandalism, storm, or other similar event, in excess of $100, may be claimed as an itemized deduction. A homeowner is entitled to a casualty loss deduction to the extent the loss from each separate casualty exceeds $100. Any insurance recoveries reduce the amount of the loss that may be claimed. A casualty must be the result of the damage or destruction of property resulting from an identifiable event that is sudden, unexpected, or unusual in nature. Damages to property caused by termites, settling, or progressive deterioration cannot be claimed as a casualty loss.

B. Tax Deductions on the Purchase of a Home.

In general, closing costs paid by the home buyer are not tax deductible items. This includes state and local recording and transfer taxes. To the extent they are not deductible, most closing costs (excluding prepaid items placed in escrow) may be added to the buyer's purchase price to increase the basis of the property. The buyer may, however, deduct payments of interest made at closing, including points charged to the buyer by the lender that constitute interest payments. Points are considered interest if they are solely for the use of money and not for specific services provided by the lender. For homes purchased on or after January 1, 1991, VA loan origination fees are considered interest and are deductible. The buyer may also have a tax

deduction for the payment of his portion of real estate taxes if his closing costs included a reimbursement to the seller for real estate taxes previously paid by the seller.

C. Tax Consequences in Selling a Home.

The sale of a principal residence is treated as the sale of a capital asset and any gain or profit may be subject to taxation as a capital gain. The Taxpayer Relief Act of 1997 made significant changes to the tax consequences of selling a home. The legislation repeals the rollover provisions of I.R.C. § 1034 (which allowed taxpayers to defer gain from the sale of a principal residence provided they replaced it within a specified period of time). I.R.C. § 1034 is repealed effective 5 August 1997. Nonetheless, I.R.C. § 1034 remains in effect for anyone who sold a home prior to 7 May 1997. (Note: It is also in effect for anyone who sold his home between 7 May 1997 and 5 August 1997, but most taxpayers who sold their home during this period will pay less taxes by electing to exclude this gain under the new I.R.C. § 121).

I.R.C. § 121 has been amended so that taxpayers who sell their home after 7 May 1997 can exclude the gain on the sale of the home, provided they meet certain requirements. Taxpayers can exclude up to $250,000 ($500,000 if married filing jointly) gain from their sale of their home. In order to qualify a taxpayer must have lived in his home for two of the previous five years. Additionally, taxpayers selling their home between 5 August 1997 and 4 August 1999 can exclude a pro rata share of the gain even if they did not live in the home for two years. For example, if a taxpayer sells his home during this two year period and only lives in it for one year, he would be able to exclude 1/2 of the otherwise allowable exclusion (i.e., $125,000 for single taxpayer, which is 1/2 of the otherwise allowable $250,000). After 4 August 1999, taxpayers can only exclude a pro rata portion of the gain if the sale was because of a change of place of employment, health, or, to the extent provided in regulations, unforeseen circumstances (Note: Regulations do not currently exist in this new area of the law).

If a taxpayer sold his home before 5 August 1997 and cannot qualify for the exclusion of gain provided under I.R.C. § 121, the taxpayer can still avoid paying taxes on the sale by rolling the gain over into a new home. The tax on the gain will only be deferred, however, if a replacement home of equal or greater cost is purchased within a prescribed period. A loss on the sale of a home does not qualify for a tax deduction.

For sales of principal residences prior to 5 August 1997, the tax on the gain can be deferred, but not canceled, if a new principal residence is purchased and occupied within 24 months before or after the sale of the old residence. The replacement period is extended to up to four years from the date of sale for active duty soldiers. Additional time is available for service members who are stationed overseas, or who after returning from overseas tours, are required to reside in on-post quarters because adequate off-post housing is not available. In these instances, the replacement period lasts until one year after the last day the member is stationed outside the United States, or one year after the member is no longer required to reside on-post, but in either case, no longer than eight years after the date the old residence was sold.

The deferral of gain applies only to the sale of a taxpayer's principal residence, which includes a condominium or cooperative apartment, mobile home, and even a houseboat. A vacation cabin or second home does not qualify. The deferral can be used and extended over and

over again in a series of sales and qualifying replacements. The deferral cannot, however, be used more than once every 24 months unless the sale is occasioned by a change in employment location which qualifies for a moving expense deduction. The sale of a home in which the deferral or gain applies should be reported to the Internal Revenue Service on IRS Form 2119, Sale or Exchange of Principal Residence. This form should be submitted as an attachment to the taxpayer's annual tax return.

For more information on the tax consequences of selling a home, *see* Emswiler, *Tax Consequences of Renting and Then Selling a Residence*, THE ARMY LAWYER, at 3 (October 1995). *See also* IRS PUBLICATION NUMBER 523, TAX INFORMATION ON SELLING YOUR HOME.

1. The "Over 55" Exclusion only applies to sales of homes prior to 7 May 1997.

"Old" I.R.C. § 121 of the Code provides a significant tax benefit to homeowners over 55 years of age who sell their homes after July 26, 1978 and before 7 May 1997. "Old" I.R.C. § 121 permits such taxpayers to exclude from their gross income up to $125,000 of gain realized on the sale of their principal residence, including deferred gain from the purchase and sale of other homes over the years. To qualify, the homeowner must have used the home as his principal residence for at least three of the five years before the date of sale. The exclusion can only be used once in a lifetime. Thus, if a taxpayer uses only a portion of the $125,000, the balance is lost forever. If a husband and wife own a home together, only one spouse need be over 55 years of age; but only one $125,000 exclusion is available for a husband and wife.

2. Installment Sales.

A taxpayer may spread the tax payment on the gain from the sale of his home to subsequent years through the use of a qualifying installment sale. The tax-saving feature is that the taxpayer pays tax on the gain over a period of years. As each installment payment of the purchase price is received, the taxpayer pays tax on the percentage of the gain received each year. By spreading the payments over a number of years, this may place the taxpayer in a lower tax bracket and thus reduce his taxes overall.

D. Conversion of Residence to Rental Property.

If a homeowner discontinues the use of a home as his personal residence and converts it solely to rental property with an intent to profit from its rental, the property is then considered business or income producing property. The amount received as rental income must be included in the taxpayer's gross income. Expenses incurred in connection with the rental are also deductible. Expenses include depreciation, maintenance and repairs (but not improvements, which may only be depreciated), hazard insurance premiums, utility costs, property management fees, real estate taxes, and interest. All rental income and deductions are reported on Schedule E, Supplemental Income Schedule, Form 1040. For information on rental activities, consult IRS Publication Number 527, Rental Property.

E. Rental of Vacation Home.

The tax treatment on the rental of a vacation home depends on the amount of the homeowner's personal use of the property. In each of the following cases, personal use includes use by any owner and by any member of his family.

First, if the property is rented less than 15 days during the year, and there is at least some personal use of the property, then none of the rental income is taxable. Similarly, expenses related to the rental are not deductible, except that interest and taxes may be taken as itemized deductions.

Second, if the property is rented at fair value for 15 or more days, and if the personal use exceeds the greater of 14 days or 10% of the number of days that the property is rented, then the rental income is taxable; but only the portion of the total rental expenses directly related to the rental days may be deducted. In addition, the expenses that may be claimed cannot exceed the rental income. Expenses must also be taken in the following order: (i) interest, property taxes, and casualty losses; (ii) operating and maintenance expenses; and (iii) depreciation. However, excess interest and taxes may be claimed as itemized deductions.

Third, if the property is rented for 15 days or more with a profit motive, but the personal use is less than the greater of 15 days or 10% of the number of days of rental, then expenses in excess of rental income may be deducted. However, expenses must be prorated based on the amount of rental versus personal use.

Finally, if there is no personal use and the property is rented or held for rent with a profit motive, then such property is considered investment property and all expenses related to the rental, including depreciation, are deductible and are not limited to the amount of rental income.

CHAPTER 2

REAL ESTATE SALES CHECKLISTS

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PRE-CONTRACT CHECKLIST

A. Determine Status of Transaction.

1. Advice to seller. (Preferable if house has not been listed yet with any broker.)

- ❑ Tell the client NOT TO SIGN any listing agreement (sometimes called a brokerage agreement) without first having it reviewed by you or another attorney.
- ❑ Tell the client NOT TO MAKE any oral listing without making it subject to this clause: "My attorney's usual brokerage agreement which will have to be signed before we agree on final terms."
- ❑ Tell the client NOT TO AGREE to final terms and NOT TO SIGN a binder/purchase offer/preliminary contract or accept a deposit without first checking with either you or another attorney.
- ❑ Tell the client you are available to prepare the contract (if this is within your expertise and if permitted by the local Staff Judge Advocate; if not, tell the client to bring any standard contracts to you for review before signing). Tell the client that you are also available to prepare the binder. Make sure that the client knows to secure a signed brokerage agreement before he or she signs the binder.

2. Advice to buyer.

- ❑ The advice as to binders is identical. IF it is to be used, YOU, as the attorney, want to control how binding or unbinding it is to be. At best, if it is not binding, it is an indication of good faith.
- ❑ Try to get a commitment from seller that all other selling efforts will be discontinued - or at least held in abeyance until contract and then discontinued.
- ❑ The broker or agent does not ordinarily work for the buyer. Make sure that no special arrangements are or were made that could result in a claim for compensation or commission from the broker or agent against the buyer.

3. Advice to clients if a binder has already been signed and the main elements of the deal have been agreed upon:

- ❑ Seller's attorney must get a brokerage agreement signed before "any further contract negotiation and signing," if at all possible. You want to avoid a liability to broker in the event the deal does not close.

- ❑ As attorney for either the seller or the buyer, you want flexibility to get all the contract provisions needed to protect the client - and you do NOT WANT THE BINDER TO BE THE CONTRACT. The binder ordinarily will not be the contract if it does not express ALL THE MATERIAL TERMS BETWEEN THE PARTIES.

B. Know your client.

1. The client's file should contain as much basic detail as is practical to obtain. In addition to name, address and telephone numbers, it may become important to learn considerably more. For instance, as to an individual contemplating the purchase of residential property, proper representation could require information as to present, prior and any future contemplated marital status, and number and age of others who will reside in the property.

2. Administratively: Set up a file - with easy access to:

- ❑ Client identity and identity of the opposite party, including business and residence addresses and phone numbers.
- ❑ Broker information, including real estate firm, sales representative, phone, address, and commission arrangement.
- ❑ Lender's name, address, phone, and mortgage officer.
- ❑ Title Company, including title number and reader or clearance officer.
- ❑ Other interested parties.

C. Know your client's needs and requirements and identify the purposes of the transaction (make notations in file).

1. Seller.

- ❑ Reason for sale. Transfer, divorce, retirement, purchase of another home, moving to an apartment?
- ❑ Financial - identify the extent of the need for cash. Can seller take a purchase-money mortgage or other deferred payment? Does seller want to get out of the mortgage obligation? Is seller willing to be subject to payment of points if buyer finances by VA- or FHA-insured mortgage? Are proceeds needed for another transaction? When?
- ❑ Time and possession requirements. New job? PCS date? Time of essence? Marriage? Children? School?
- ❑ Tax considerations and options, if any. See § XII of Chapter 1, JA 261, Real Property Guide.

- ❑ 38 U.S.C. § 1817 provides for a release from liability on the part of a veteran when he or she sells such property and the loan is to be assumed by a new buyer and allows such a loan to be continued if:
  - ❍ The loan is current.
  - ❍ The purchaser-transferee is acceptable to the VA from an income and credit standpoint.
  - ❍ If the purchaser-transferee assumes the loan.
  - ❍ If the purchaser-transferee also assumes the indemnity obligation.
  - ❍ Certain costs and a transfer fee are paid.
- ❑ The veteran should provide in the sale contract that the purchaser will assume all loan obligations, including his or her potential indemnity liability if there is a guaranteed or insured loan, and that the sale will not be consummated unless and until the VA approves the income and credit of the purchaser.
- ❑ Compliance will entitle the veteran to apply for a release upon completion of the transaction.
- ❑ Anything else? Depends on your knowledge of client and needs.

2. Buyer.

- ❑ Reason for purchase. Coming from an apartment? Lease termination? Is present home being sold? Closing date? Coordination needed? Are alteration, demolition, or conversion a possibility or planned? Are variances or other zoning changes needed if alteration, demolition, or conversion is considered?
- ❑ Availability of cash and other sources of financing. Does buyer desire VA or FHA financing?
- ❑ Time and possession requirements. Is time considered of the essence? Is a penalty provision desirable? This may be related to the reason for purchase.
- ❑ Tax structuring. Is reinvestment within a limited time period critical? (For example, rollover of capital gains into a new principal residence within time guidelines specified under tax law.)
- ❑ Tax considerations of form of ownership. Tenancy by the entirety, tenancy in common, or individual tenancy? If a couple is unmarried, tenancy in common may be preferable to joint tenancy. If the parties are named as husband and wife, joint tenancy or tenancy by the entirety may be created by statute.

D. Both attorneys need the following information. (Some of this information is obtained first by the seller's attorney from the seller, then by the purchaser's attorney from seller's attorney - *preferably before* the meeting at which the contract is signed. Some of the information may not be available either before or even at the signing of the contract. In such circumstances, appropriate contract provisions should be added.)

- ❑ Zoning compliance as to structures and present and contemplated use. If not available, purchaser makes contract "subject to."
- ❑ Certificate of Occupancy. If not available, purchaser tries to require seller to obtain. Particularly important if alterations made.
- ❑ Landmark or historic district designation. Seller should recite, if known. Purchaser should inquire particularly if changes may be contemplated.
- ❑ Wetlands designations - will affect ability to build.
- ❑ Flood area designations - may affect ability to obtain a mortgage.
- ❑ Pending and contemplated eminent domain proceedings. In some areas, recent improvements may mean added assessments or taxes.
- ❑ Real estate tax, assessment, and other lien? Veteran exemption? Inquire as to percentage of Equalization Rate, percentage of commercial and potential impact of 100% valuation.
- ❑ Copies of notes, bonds, mortgages, and insurance policies that will survive the closing. Read them. Are there prepayment provisions, prohibitions on subordinate financing? Is there adequate insurance coverage, both as to type and amount?
- ❑ Copies of restrictions, easements, agreements, continuing leases, licenses, etc. Must be compared to survey and to client's needs and planned use.
- ❑ Latest survey information. Review carefully. Do buildings have four walls? Some banks require new surveys routinely. Purchaser should try to avoid the expense - but only where appropriate.
- ❑ Physical condition of premises, such as termite conditions, violations, etc. Has a termite inspection certificate been provided? Availability of legal access and all utilities. Also check against survey. Note fences, hedges, added swimming pool, structures, etc. (Some jurisdictions require swimming pools to be fenced. Check for compliance.)
- ❑ Leases, tenancies and other possessory information, including rent control or stabilization status, rentals collected, security deposits, painting schedules, etc. (these should be recited in contract and confirmed by attorneys and parties).
- ❑ Broker information, such as agreements, listings, negotiations, etc. Contract may contain representations and even provisions for indemnification by purchaser. Get accurate and complete information.

- ❑ Capacity and competency of all contracting parties. Don't take for granted, except as to persons you see and talk to.
- ❑ Extent of agreements on price and other terms, including personal property, etc.
- ❑ Specific listing of all personal property included in the sale. If important, order U.C.C. search.
- ❑ Best available property description, including easements appurtenant. Location - street number description, legal description, plus easements appurtenant. Check against existing survey or filed map.
- ❑ Obtain a copy of the seller's existing title report, if possible.

E. Additional information particularly necessary for ***seller's attorney***.

- ❑ Seller's title policy, title report or abstract, and attorney's opinion. Does it cover zoning, Certificate of Occupancy, violations, wetlands, flood areas, etc.?
- ❑ Deed, will, or other source of title, boundary agreements, additional deeds received or given after initial purchase, and Torrens duplicate, if registered.
- ❑ Any death or divorce information affecting title since acquisition. Death in chain will also result in questions re: estate taxes, debts, legacies, after-born children, possible spousal right of election, etc. Ask specifically if same as persons named in deed of acquisition. (Note: Corporations also change names and the present "ABC Corp." may be different than the "ABC Corp." that purchased the property.)
- ❑ Latest real estate tax bills, any special assessments, and any installment assessment data. Check for arrears. Also maintenance charges, Association dues, municipal liens, franchise taxes, mechanics' liens, etc.
- ❑ Copies of mortgage(s), any obligation(s) (any acceleration or prepayment), and any agreements with respect thereto together with their status. For example, extension agreements, consolidations, releases, etc.
- ❑ Information as to any litigation pending. Inquire! Any notices? Zoning, street widening, condemnation?
- ❑ Outstanding contracts or options, whether or not in default.
- ❑ Any other information?

F. Additional information needed by ***buyer's attorney***.

- ❑ Identity of the actual grantee and current status (i.e., single, married, separated, divorced, etc.).
- ❑ Source of the consideration and its availability. Funds must be in the form the contract will require.

- ❑ Are any approvals required (e.g., Home Owners Association, provisions in restrictive covenants)?
- ❑ Check availability of utilities (particularly important if this is part of a breakup of a larger parcel).

CAPACITY AND COMPETENCE

Whenever a party to the contract falls within one of the categories listed below, state law must be examined to determine whether the party has the requisite capacity and competence.

- ❑ Individual adult: dower and curtesy.
- ❑ Alien owner.
- ❑ Multiple owners.
- ❑ General partners - title in name of partners or partnership.
- ❑ Limited partners.
- ❑ Joint ventures.
- ❑ Stock corporations: domestic and foreign.
- ❑ Not-for-profit corporations.
- ❑ Religious corporations.
- ❑ Governmental and municipal corporations.
- ❑ Benevolent orders.
- ❑ Unincorporated associations.
- ❑ Attorney-in-fact.
- ❑ Trustees.
- ❑ Executors.
- ❑ Infants.
- ❑ Incompetents.

CONTRACT OF SALE CHECKLIST

A. Legal description - covers:

- ❑ Land and buildings.
- ❑ Appurtenances - e.g., easements which benefit premises.
- ❑ Fixtures, equipment, and personal property included in sale.

B. Adjustments:

1. Real estate taxes - consider:

   - ❑ Multiple tax jurisdictions with differing fiscal years.
   - ❑ Real estate taxes may be paid a year or more in arrears in some states.
   - ❑ Tax (or insurance) escrows held by a mortgagee are a credit to the seller.

2. Insurance - parties must determine whether policies are transferable, and the buyer must decide whether to take over the seller's insurance or obtain own insurance.

C. Default:

- ❑ Seller wants sole liability to be return of a down payment (without interest?) plus title examination and survey charges. Buyer should not accept in case of willful default.
- ❑ Buyer may want his sole liability to be retention of the down payment by the seller.
- ❑ It is advisable for the down payment to be held in escrow, usually with the seller's attorney. The terms of escrow should be spelled out in detail. Consider investment of the deposit if it is substantial or there will be a long interval between contract and closing.

D. Brokerage - parties should represent that they have dealt with no one other than the specified broker, and one party (usually seller) should agree to pay commission.

E. Conditions to closing:

- ❑ Infinite variety - typical would be buyer's ability to obtain a mortgage commitment.
- ❑ Seller - avoid "blank check" conditions - e.g., "satisfactory" completion by buyer of investigation into physical condition & financial aspects of premises.

F. Closing:

- ❑ Date of closing (or notice mechanics for setting a closing date) should be specified in detail.
- ❑ Time of the essence, if desired.
- ❑ It is helpful to give the attorneys for seller and buyer the express right to stipulate to adjustments of the closing date.

G. Closing deliveries - usually specified in considerable detail.

- ❑ Deed - what form?
- ❑ Miscellaneous assignments - warranties by appliance manufacturers and contractors, trade names, service marks, insurance policies, and unpaid proceeds.
- ❑ Letters to tenants and contractors notifying them of sale.
- ❑ Security deposits (delivery of check or assignment of bank account).
- ❑ Estoppel certificates or letters.
- ❑ Current tax bills.
- ❑ Mortgages affecting premises.
- ❑ Insurance policies (if being transferred).
- ❑ Certificate of occupancy, licenses, and permits.
- ❑ Architectural plans for premises.

H. Closing expenses:

- ❑ Spell out.
- ❑ In some states buyer orders and pays for own title insurance. In other states, seller customarily pays this expense.
- ❑ Assignment - right to assign may be given in a residential contract, perhaps with restrictions. If not wanted, the contract should specifically preclude assignment.

CHECKLIST FOR A NEW HOUSE

You can judge the quality of a new house pretty accurately if you look around carefully, prying and poking in all the corners. Of course, some parts of a house--the wiring, for example--are always partly hidden. To judge these parts, get the builder's specifications. You should check the builder's reputation, too. You may want to hire a housing inspector to provide a written report. Here is a list of specific things to look for.

A. The Bathroom.

- ❑ Flush the toilet and watch the water. If it runs straight down the sides of the bowl, the fixture is probably an economy model. If you see separate streams, it is of a better grade. If the streams swirl, it is a quality bowl.
- ❑ Listen as the tank refills. If it's noisy, somebody has saved from $2.50 to $4 on the flush mechanism; that's about the extra cost of a quiet type.
- ❑ Look for a trademark on the fixtures. If there is none, it may be an indication that the fixtures are second-line. They may have been made by a top manufacturer, but since they are his cheaper goods, he decided to leave his name off.
- ❑ Measure the top of the wash bowl. It should be at least 20 by 24 inches. This is the smallest bowl used by good builders. Smaller bowls--15 by 17 inches or 18 by 20--indicate a builder has really cut corners in an effort to save about $4.
- ❑ Notice the faucet handles. The simple four-spoke ones are the least expensive, indicating low quality.
- ❑ Turn on the hot-water faucet. If you get hot water at once, the plumbing probably circulates on an "upfeed and gravity return" system, the best and an indication of good construction.
- ❑ Examine the shower head. It should swivel on a ball joint; all but the cheapest do. It should also have a lever for adjusting the spray. In addition, the plate that creates the spray should be made of plastic to reduce clogging of materials.
- ❑ Check for shut-off valves on the pipes under the washbowl and the flush tank. Their absence means that the builder saved $3 or $4 at the cost of almost certain inconvenience.

B. The Basement or Utility Area.

- ❑ Check the heating system carefully. If it's a warm-air system, look for a pulley-driven air blower, a 10-year guarantee on the heater, duct outlets at the base of outside walls. In a hot-water system, the boiler should be cast iron, have at least a 20-year guarantee, and bear the IBR seal of the Institute of Boiler and Radiator Manufacturers and the H of the American Society of

Mechanical Engineers. On gas-fired burners, look for the AGA of the American Gas Association. If the home is all-electric, check installation with the local utility office.

- ❑ Hot-water pipes should be copper; cold-water, copper or plastic. Long hot-water pipes should be insulated.
- ❑ Examine the hot-water heater. It should have a 40-to-50 gallon capacity if it is gas, 80 gallons if electric.
- ❑ Look at the plate or placard on the electricity switchbox. It should show 240 volts and 100 amps, or, preferably, 150 amps. Count the circuits; eight is the minimum for a small house, 12 for a large one.

C. The Kitchen.

- ❑ Turn on the hot-water faucet to see if you get hot water almost at once.
- ❑ Look under the sink for shut-off valves, as in the bathroom.
- ❑ Pull out a kitchen drawer. If it is on rollers, that's one more touch of quality you can give the builder credit for.

D. Windows and Doors.

- ❑ Grasp the knobs of all outside doors and try to rattle them. Doors should fit snugly and also have weather stripping that closes the gaps between edges and frames.
- ❑ Give all the windows a similar test. Make sure that there is weather stripping between the movable sash and the frames. If the sashes are made of metal, look for plastic slide tracks. They make widows easier to open.
- ❑ Check the way the frames of all windows and doors fit into the exterior wall of the house. Any gaps or cracks at the edges are infallible signs of inferior workmanship.

E. Masonry and Floors.

- ❑ Examine brick or concrete blocks to be sure they're laid in even rows, an even spread of mortar between them.
- ❑ Be sure hardwood floors are tightly fitted, with no high edges or gaps between boards. The longer each board, the better. As you walk, listen for creaks. There should be none.
- ❑ Look for high-grade flooring. Oak or maple tongue-and-groove boards remain a hallmark of quality, but the lack of them does not indicate a substandard house. Many people prefer one of the newer materials.

F. Invisible Fundamentals.

- ❑ Check even the parts of a house you cannot see by using the builder's specifications. Make sure, for example, that the foundation has a poured concrete footing that lies below the frost line. This will prevent settling. Most building codes specify proper footing depth.
- ❑ For quiet rooms, interior walls should be made of wallboard ½ inch thick, not the 3/8-inch grade.
- ❑ See that the roof shingles, if of asphalt composition, are windproof and of at least 235-pound weight. Some people prefer wood shingles.
- ❑ Be sure the insulation is of the blanket, batt or foil type. Thickness needed for a cold climate-like that of the upper Mississippi Valley: roof, 6 inches; walls, 3 inches.

G. Evaluating the Floor Plan.

- ❑ A well-thought-out floor plan gives a house more than just step-saving convenience and comfort. It adds a feeling of space and provides privacy for each member of the family when wanted, two things that make a house a satisfying place in which to live. A bad floor plan is also a bad investment, for it downgrades the resale value of the house. Appraisers have a sharp eye for poor layout. They also tend to distrust unusual floor plans, even if they are actually quite efficient. This is something to remember if you ask the builder to incorporate design idiosyncrasies you happen to prefer. It may be well worth it to you, but you should be prepared for the fact that these unusual touches could cost you money if you sold the house.
- ❑ Good interior design divides a house into three principal zones, all separated: work and play ("work" meaning kitchen work), bedroom and bath, living and dining. The noisy work and play area should not intrude on the living and dining area; the bedroom and bath area should be secluded. Some families also require a quiet work area--a study or den. The designer must relate the zones so that while activities remain separated there is an easy flow throughout the house.
- ❑ Time and motion studies have shown that the best kitchen arrangement is the "kitchen triangle." This step-saving design places the three major appliances --refrigerator, range, and sink -- on two legs of a triangle. The total of the sides of the triangle should be 23 to 26 feet. Serving space should be outside the triangle of working space.
- ❑ The family room should, modern designers say, be on the same level as the kitchen, rather than down a flight of stairs in the basement, the popular spot two decades ago.
- ❑ There should be at least three bedrooms, each with a minimum of four feet of closet space per person.

- ❑ Two bathrooms are now a minimum; one should adjoin the master bedroom.
- ❑ The laundry area should have at least 3.5 feet of space in front of appliances.
- ❑ General storage--not counting closets, kitchen cabinets, and so on -- should provide about 800 cubic feet of space.
- ❑ Finally, do not ignore an instinctive feeling that somehow a house is just not right. It may meet all measurable requirements and still make you edgy. Conversely, do not buy a house just because you "love" it.

CHECKLIST FOR AN OLDER HOUSE

A. The fundamental difference between judging an old house and judging a new one is that the quality of workmanship and materials originally put into the old house is no longer your primary concern. The question is how well they have withstood the test of time.

B. Go straight to the basement to learn the worst, spending only enough time in the living area to get a general impression. If the impression is favorable, head downstairs fast--before any infatuation with the house or with the charm of its setting blinds you to signs of decay that may lie below ground. That is where structural defects are most likely to show up. If they're extensive, repairs can greatly increase the cost of the house.

- ❑ Tour the foundation walls looking for cracks, crumbling mortar or other evidence of deterioration--or fresh patches indicating a recent cover-up.
- ❑ Look over the walls for a "high-water mark." This often is visible if a basement has been flooded. Look also for any signs of leaks or seepage on the walls and floor.
- ❑ Also look for a sump pump installed to remove water. Its presence could be a sign of serious flooding problems. Pumps are often concealed under wooden hatch covers.
- ❑ Even if there are no signs of water having entered, sniff around for odors. These could be danger signals. Call in an expert before you go further.
- ❑ Check any exposed structural beams--especially the timbers, called joists, that support the floor above. Water seeping down from the kitchen and bathrooms above can rot them.
- ❑ See if the joists have been notched for pipes so deeply as to weaken them. One third of the depth is the maximum for safe notching. Joists pulled away from supporting masonry indicate wall movement.
- ❑ If joists are shored up by intermediate jackposts or timbers, ask an expert why.
- ❑ Get an expert to inspect foundation walls inside and out for signs of termites at work. Termites travel up foundation walls to get to the woodwork above, using mud tunnels that look like ordinary dirt streaks. Termites are now found in all parts of the U.S., and they are so destructive that the Federal Housing Administration and Veterans Administration frequently require a "no-termite certification" before they will approve mortgage loans on old houses. Brokers often urge sellers to get the certification as an added selling point; if this had not been done, it is worth paying for yourself. Make sure the inspection is made by a recognized pest control operator, most of whom are members of the National Pest Control Association or a state pest-control association.

C. Before returning to the living area, walk around outside.

- ❑ See if the chimney has separated from the house. Look for missing mortar and broken bricks.
- ❑ If there are stone or brick walls, look for mortar-joint cracks in a stair step pattern--evidence of a major separation. An extra-wide mortar joint in this pattern may be a sign that such a crack has been repaired.
- ❑ On your rounds, examine window sills and frames, where deterioration often begins. Are they freshly painted--with no fresh paint on the rest of the house? Why? The paint may be covering rot. Get an expert's opinion.
- ❑ Look at the gutters. Are there any signs of breaks or leaks? Down spouts should lead directly to underground drainage at least three feet away from the house or to storm sewers.

D. To do a thorough job, make your next stop the roof (or send up a professional roofer).

- ❑ Look for broken or missing shingles, or -- in a roof that is surfaced with layers of gravel and asphalt -- for bubbles and/or peeling or broken patches.
- ❑ Look at the flashing--the boot-like coverings that prevent leaks around chimneys and vent pipes. It should be intact and watertight of nonrusting copper, aluminum or plastic.

E. If you can get into the attic or crawl space, check underneath the roof with a flashlight, looking for telltale water stains that signal leaks.

F. Now it is time to go back into the house. Use the checklist for a new house as a general guide, but keep in mind that components have changed, and age will have to be taken into account. Once again, do not ignore your personal reaction. You are going to have to live in that house if you buy it.

CONDO CHECKLIST

A. Physical Characteristics.

- ❑ Available parking.
- ❑ Storage space.
- ❑ Sound-proofing.
- ❑ Recreational facilities.
- ❑ Security.
- ❑ Appearance and upkeep of the common elements.
- ❑ Quality of professional management.
- ❑ Separate metering of utilities.
- ❑ In condominium conversions, engineering report on condition of building and equipment (roof, foundations, heating and cooling systems, elevators, plumbing and electrical systems).
- ❑ Laundry facilities.

B. Financial Matters.

- ❑ Settlement costs.
- ❑ Monthly condominium assessment or fee.
- ❑ Hazard and liability insurance, amounts and limits.
- ❑ Included in condominium fee?
- ❑ Adequacy of current operating budget and soundness of most recent financial statement for the condominium.
- ❑ Adequacy of reserves for repairs and improvements.
- ❑ Warranties on appliances.
- ❑ Any outstanding lawsuits by or against the condominium.

C. Other Matters.

- ❑ Rental policy.
- ❑ Restrictions on resales of units.
- ❑ Restrictions on use of units.

CHAPTER 3

FORMS FOR THE BUYING AND SELLING OF REAL ESTATE

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I. NONEXCLUSIVE BROKERAGE AGREEMENT.

NONEXCLUSIVE BROKERAGE AGREEMENT

If you (*insert name of agent, agency, or broker*) procure a buyer for the sale of my premises at (*insert address*), your commission shall be (*insert rate*). The commission shall be deemed earned only when, as, and if title actually closes upon terms and conditions that are in all respects satisfactory to me, in accordance with a written contract embodying those terms and conditions as well as such others, both as to form and substance, as are required by my counsel. The particulars given by me to you are subject at all times to changes by me. Moreover, the submission of any particulars shall in all instances be subject to any prior sale and withdrawal from the market without prior notice to you. I shall not be responsible for any inaccuracies or errors by you regarding particulars or any other information supplied by me.

Failure to close title for any reason whatsoever shall excuse me completely from any liability for the payment of any commissions. Without limiting the foregoing, I shall have the right to break off negotiations with any prospect submitted by you for any reason whatsoever at any stage of negotiations.

It is understood further that neither you nor I may claim any change or modification in the terms of this letter or any termination of the stipulations and conditions herein unless set forth in a writing signed by the party against whom the modification is claimed.

____
Owner

Accepted for [*insert name of agency*] by ________________________

II. CONTRACT OF SALE.

CONTRACT OF SALE

CONTRACT OF SALE made this _____ day of _______________, 19___, between (*BUYER*), of (street and city address), hereafter called BUYER, who agrees to buy, and (*SELLER*), of (*street and city address*), hereafter called "SELLER", who agrees to sell: the property, including all buildings and improvements thereon (the "PREMISES") (more fully described on a separate page marked "Schedule A") and also known as:

Street Address: ____.

Tax Map Designation: ______________________________________.

Together with SELLER'S interest, if any, in streets and unpaid awards as set forth below.

The sale also includes all fixtures and articles of personal property attached to or used in connection with the PREMISES, unless specifically excluded below. SELLER states that they are paid for and owned by SELLER free and clear of any lien other than the EXISTING MORTGAGE(S). They include but are not limited to plumbing, heating, lighting and cooking fixtures, bathroom and kitchen cabinets, mantels, door mirrors, venetian blinds, shades, screens, awnings, storm windows, window boxes, storm doors, mail boxes, weather vanes, flagpoles, pumps, shrubbery, fencing, outdoor statuary, tool sheds, dishwashers, washing machines, clothes dryers, garbage disposal units, ranges, refrigerators, freezers, air conditioning equipment and installations, and wall-to-wall carpeting.

Excluded from this sale are: Furniture and household furnishings.

A. Purchase price.

1. The purchase price is $ ________, payable as follows:

   On the signing of this contract, by check subject to collection: $ _________

   By allowance for the principal amount still unpaid on EXISTING MORTGAGE(S): $ _________

   By a Purchase Money Note and Mortgage from BUYER (or assigns) to SELLER: $ _________

   BALANCE AT CLOSING: $ _________

2. Existing mortgage provisions.

   a) If this sale is subject to an EXISTING MORTGAGE, the Purchase Money Note and Mortgage will also provide that it will remain subject to the prior lien of any EXISTING MORTGAGE even though the EXISTING MORTGAGE is extended or modified in good faith. The Purchase Money Note and Mortgage shall be drawn by the attorney for SELLER. BUYER shall pay the mortgage recording tax, recording fees, and the attorney's fee in the amount of $ ______ for its preparation.

   b) If any required payments are made on an EXISTING MORTGAGE between now and CLOSING which reduce the unpaid principal amount of an EXISTING MORTGAGE below the amount shown in Paragraph 2, then the balance of the price payable at CLOSING will be adjusted. SELLER agrees that the amount shown in Paragraph 2 is reasonably correct and that only payments required by the EXISTING MORTGAGE will be made.

   c) If there is a mortgage escrow account that is maintained for the purpose of paying taxes or insurance, etc., SELLER shall assign it to BUYER, if it can be assigned. In that event, BUYER shall pay the amount in the escrow account to SELLER at CLOSING.

   d) The PREMISES will be conveyed subject to the continuing lien of "EXISTING MORTGAGE(S)" as follows:

   Mortgage now in the unpaid principal amount of $ ______ and interest at the rate of _______ percent per year, presently payable (period of payment, such as monthly, annually, etc.) in installments of $ _________ which include principal and interest, and with any remaining balance of principal being due and payable on

   ______________.

   SELLER hereby states that no EXISTING MORTGAGE contains any provision that permits the holder of the mortgage to require its immediate payment in full or to change any other terms thereof by reasons of the fact of CLOSING.

B. **Method of payment.** All money payable under this contract, unless otherwise specified shall be either:

1. Cash, but not over one thousand ($1,000.00) dollars.

2. Certified check of BUYER, or official check of any bank, savings bank, trust company, or savings and loan association having a banking office in the State of _______________, payable to the order of SELLER, or to the order of BUYER and duly endorsed by BUYER _______________ to the order of SELLER in the presence of SELLER or SELLER'S attorney.

3. Money other than the purchase price, payable to SELLER at CLOSING, may be by check of BUYER up to the amount of ___________________ ($ _________) dollars, or

4. As otherwise agreed to in writing by SELLER or SELLER'S attorney.

C. The PREMISES are to be transferred subject to:

1. Laws and governmental regulations that affect the use and maintenance of the PREMISES, provided that they are not violated by the buildings and improvements erected on the PREMISES.

2. Consents for the erection of any structures on, under, or above any streets on which the PREMISES abut.

3. Encroachment of stoops, areas, cellar steps, trim, and cornices, if any, upon any street or highway.

D. Title. SELLER shall give and BUYER shall accept such title as a member of The _____________________ Board of Title Underwriters, will be willing to approve and insure in accordance with their standard form of title policy, subject only to the matters provided for in this contract.

E. Closing.

1. "CLOSING" means the settlement of the obligations of SELLER and BUYER to each other under this contract, including the payment of the purchase price to SELLER, and the delivery to BUYER of a _____________________ deed in proper statutory form for recording so as to transfer full ownership (fee simple title) to the PREMISES, free of all encumbrances except as herein stated. The deed will contain a covenant by SELLER that there are no other restrictions, or encumbrances, on the premises other than those of records or listed herein. If SELLER is a corporation, it will deliver to BUYER at the time of CLOSING (a) a resolution of its Board of Directors authorizing the sale and delivery of the deed and (b) a certificate by the Secretary or Assistant Secretary of the corporation certifying such resolution and setting forth facts showing that the transfer is in conformity with powers of the corporation.

2. Place of closing. CLOSING will take place at the office of ___________ at ___________ o'clock on _____________, 19___.

F. **Broker.** BUYER hereby states that BUYER has not dealt with any broker in connection with this sale other than __________ and SELLER agrees to pay the broker the commission earned thereby (pursuant to separate agreement).

G. **Easements, streets, and highways.** This sale includes all of SELLER'S ownership and rights, if any, in any land lying in the bed of any street or highway, opened or proposed, in front of or adjoining the PREMISES to the center line thereof. It also includes any right of SELLER to any unpaid award by reason of any taking by condemnation and/or for any damage to the PREMISES by reason of change of grade of any street or highway. SELLER will deliver at no additional cost to BUYER, at CLOSING, or thereafter, on demand, any documents which BUYER may require to collect the award and damages.

H. **Existing mortgage certificate.** SELLER agrees to deliver to BUYER at CLOSING a certificate dated not more than thirty (30) days before CLOSING signed by the holder of each EXISTING MORTGAGE, in form for recording, certifying the amount of the unpaid principal and interest, date of maturity, and rate of interest. SELLER shall pay the fees for recording such certificate. SELLER hereby states that any EXISTING MORTGAGE will not be in default at the time of CLOSING.

I. **Compliance with municipal ordinances.** SELLER will comply with all notes or notices of violations of law or municipal ordinances, orders, or requirements noted in or issued by any governmental department having authority as to lands, housing, buildings, fire, health and labor conditions affecting the PREMISES at the date hereof. The PREMISES shall be transferred free of them at CLOSING and this provision shall survive CLOSING. SELLER shall furnish BUYER with any authorization necessary to make the searches that could disclose these matters.

J. **Assessments.** If, at the time of CLOSING, the PREMISES are affected by an assessment which is or may become payable in annual installments, and the first installment is then a lien, or has been paid, then for the purposes of this contract all the unpaid installments shall be considered due and are to be paid by SELLER at CLOSING.

K. **Costs to be apportioned before closing.**

1. The following are to be apportioned as of midnight of the day before CLOSING: rents as and when collected; interest on EXISTING MORTGAGE(S); premiums on existing transferable insurance policies and renewals of those expiring prior to CLOSING; taxes, water charges

and sewer rents, on the basis of the fiscal period for which assessed; and fuel, if any.

2. If CLOSING shall occur before a new tax rate is fixed, the apportionment of taxes shall be upon the basis of the old tax rate for the preceding period applied to the latest assessed valuation.

3. Any errors or omissions in computing apportionments at CLOSING shall be corrected. This provision shall survive CLOSING.

4. If there be a water meter on the PREMISES, SELLER shall furnish a reading to a date not more than thirty (30) days before CLOSING date and the unfixed meter charge and sewer rent, if any, shall be apportioned on the basis of such last reading.

L. **Adjustments for unpaid taxes and utilities.** SELLER has the option to credit BUYER as an adjustment of the purchase price with the amount of any unpaid taxes, assessments, water charges and sewer rents, together with any interest and penalties thereon to a date not less than five (5) business days after CLOSING, provided that official bills therefor computed to said date are produced at CLOSING.

M. **Other charges on assessments affecting sale.** If there is anything else affecting the sale which SELLER is obligated to pay and discharge at CLOSING, SELLER may use any portion of the balance of the purchase price to discharge it. As an alternative, SELLER may deposit money with the title insurance company employed by BUYER and required by it to assure its discharge; but only if the title insurance company will insure BUYER'S title clear of the matter or insure against its enforcement out of the PREMISES. Upon request, made within a reasonable time before CLOSING, BUYER agrees to provide separate certified checks as requested to assist in clearing up these matters.

N. **Unforeseen judgments.** If a title examination discloses judgments, bankruptcies, or other returns against persons having names the same as or similar to that of SELLER, SELLER shall deliver a satisfactory detailed affidavit at CLOSING showing that they are not against SELLER.

O. **Certified check for taxes.** At CLOSING, SELLER shall deliver a certified check payable to the order of the appropriate State, City, or County officer in the amount of any applicable transfer and/or recording tax payable by reason of the delivery or recording of the deed, together with any required tax return. BUYER agrees to duly complete the tax return and to cause the check(s) and the tax return to be delivered to the appropriate officer promptly after CLOSING.

P. **Lien for expenses of sale.** All money paid on account of this contract and the reasonable expenses of examination of the title to the PREMISES and of any survey and survey inspection charges are hereby made liens on the PREMISES and collectable out of the PREMISES. Such liens shall not continue after default in performance of the contract by BUYER.

Q. **Liability if SELLER unable to transfer title.** If SELLER is unable to transfer title to BUYER in accordance with this contract, SELLER's sole liability shall be to refund all money paid on account of this contract, plus all charges made for: (i) examining the title, (ii) any appropriate additional searches made in accordance with this contract, and (iii) survey and survey inspection charges. Upon such refund and payment, this contract shall be considered canceled, and neither SELLER nor BUYER shall have any further rights against the other.

R. **Inspection of premises.** BUYER has inspected the buildings on the PREMISES and the personal property included in this sale and is thoroughly acquainted with their condition. BUYER agrees to purchase them "as is" and in their present condition subject to reasonable use, wear, tear, and natural deterioration between now and CLOSING. BUYER shall have the right, after reasonable notice to SELLER, to inspect them before CLOSING.

S. **Merger clause.** All prior understandings and agreements between SELLER and BUYER are merged in this contract. It completely expresses their full agreement. It has been entered into after full investigation, neither party relying upon any settlements made by anyone else that is not set forth in this contract.

T. **Cancellation clause.** This contract may not be changed or canceled except in writing. The contract shall also apply to and bind the distributees, heirs, executors, administrators, successors, and assigns of the respective parties. Each of the parties hereby authorizes his attorney to agree in writing to any changes in dates and time periods provided for in this contract.

U. **The singular implies the plural when necessary.** Any singular word or term herein shall also be read as in the plural whenever the sense of this contract may require it.

________________________________ ________________________________

________________________________ ________________________________

In the Presence Of:

(1) Individual witnesses

State of _______________, County of ________________

On this _____ day of __________________, 19___, before me personally came __________________________ to me known to be the individual described in and who executed the foregoing instrument, and acknowledged that (s)he executed the same.

____
WITNESS

____
WITNESS

(2) Corporate party to contract

State of _______________, County of ________________

On this _____ day of _________________, 19___, before me personally came ___________________ to me known, who being by me duly sworn, did depose and say that (s)he resides at _____________ _______________________; that (s)he is the (identify corporate position) of (name of corporation), the corporation described in and which executed the foregoing instrument; that (s)he knows the seal of said corporation; that the seal affixed to said instrument is such corporate seal; that it was so affixed by order of the board of directors of said corporation, and that (s)he signed h___ name thereto by like order.

______________________________________ ______________________________________
WITNESS WITNESS

(3) Partnership party to contract

State of _______________, County of ________________

On this _____ day of ____________________, 19___, before me personally came ___________________________, to me known and known to me to be a partner in ___________________________, a partnership, and known to me to be the person described in and who executed the foregoing instrument in the partnership name, and did duly acknowledged that (s)he executed the foregoing instrument for and on behalf of said partnership.

____
WITNESS

____
WITNESS

III. ADDITIONAL AND ALTERNATIVE CLAUSES FOR THE CONTRACT OF SALE.

NOTE - The basic elements constituting an enforceable real estate contract are: a writing signed by the party to be charged, an adequate identification of the property, and a statement of the price. Additional "standard" provisions in most form contracts pertain to time and form of payment, existing and contemplated mortgages, personal property to be included, form of deed, apportionments, obligations and waivers as to various existing conditions affecting the property or its title, recognition of an identified broker, and time and place of closing. Special clauses are created to counteract changes in statutory or decisional law. Otherwise, existing law, whether express or implied, controls.

A. Property description addenda.

1. Place of recorded deed.

Being the same premises conveyed to SELLER by a certain deed made by _______________ dated _______________ at page ______ of Book _______________ in the Office of the Clerk of the County of ________________________.

2. Adjoining or abutting premises.

Together with all right, title and interest of SELLER, if any, in and to any strips adjoining or abutting said premises.

3. Riparian rights clause.

Together with all riparian rights of SELLER, if any, and all right, title, and interest, if any, to all lands now or formerly lying between any high and low water marks, and/or now or formerly under the waters of ________________, and any lands between said waters and the premises herein above specifically described.

B. Down payment in escrow.

The down payment shall be deemed made to SELLER by paying same to _____________ to be held in escrow pursuant to separate agreement between the parties hereto and _____________ of even date herewith.

C. Conditions with respect to obtaining mortgage financing.

1. General Conditions

a. This agreement is made upon the express condition that on or before ____________ BUYER shall: receive from a lending institution of BUYER's selection, a commitment in writing in the usual form of such lending institution, to make a first mortgage loan on the premises upon terms no less favorable than the following:

Principal:	$ ________________
Interest:	_____ per cent per annum
Terms:	To be amortized over a period of not less than _____ years from closing date.
Prepayment:	Privilege to repay at any time after the ____ year of the mortgage without penalty.

b. BUYER agrees promptly to make application to a lending institution of BUYER's selection for a first mortgage loan as hereinabove described, and to furnish and execute any information and instruments required in connection with such application and to actively cooperate in furnishing such information and documents requested by the proposed lending institution. Appraisal fees and any and all costs and charges made by the lending institution shall be paid by BUYER.

c. If BUYER shall fail to procure such commitment, then and in that event BUYER may cancel this contract by written notice to that effect sent at any time on or immediately before said date and if this contract be so canceled, then both parties shall be, and they are hereby released and discharged from all liability thereunder, except that the down payment hereunto shall be promptly refunded to BUYER.

It is hereby further agreed that if the proposed lender issuing the commitment shall fail or refuse to close the loan for any reason other than BUYER's default or failure to cooperate, then in that event this agreement, at the option of BUYER, shall be deemed canceled and both parties shall be and are hereby released and discharged from all liability hereunder except that the down payment shall be promptly refunded to BUYER.

<u>Optional Addition</u>

If BUYER shall fail to procure such commitment, BUYER shall be deemed to have waived this express condition unless BUYER shall notify SELLER in writing on or immediately before said date of BUYER's failure to procure such commitment within five (5) days from receipt of such notification. SELLER shall have the option of (1) issuing a written commitment to make a purchase money first mortgage secured by a purchase money note duly executed and acknowledged by BUYER named herein on the terms above set forth drawn by the attorney for SELLER at the expense of BUYER who shall also pay the mortgage recording tax, recording fees and mortgage title insurance charges for the benefit of the mortgage or (2) advising BUYER in writing that this contract is canceled, and in that event or in the event SELLER does not timely exercise option (2) above, both parties shall be, and they are hereby, released and discharged from all liability hereunder, except that the down payment hereunder shall be promptly refunded to BUYER."

2. In the event that BUYER contemplates obtaining either an FHA- or VA-insured mortgage, provisions similar to the following should also be considered:

a. FHA: It is expressly agreed that notwithstanding any other provisions of this Contract, BUYER shall not be obligated to complete the purchase of the property described herein or to incur any penalty by forfeiture of earnest money deposits or otherwise unless a written statement is issued by The Federal Housing Commissioner setting forth the appraised value of the property for mortgage insurance purposes of not less than $ ___________ which statement SELLER hereby agrees to deliver to BUYER promptly after such appraised value statement is made available to SELLER.

b. VA: It is expressly agreed that, notwithstanding any other provisions of this Contract, BUYER shall not incur any penalty by forfeiture of earnest money or otherwise or be obligated to complete the purchase of the property described herein if the Contract purchase price or cost exceeds the reasonable value of the property established by the Veterans Administration.

c. Neither I, nor anyone authorized to act for me, will refuse to sell or rent, after the making of a bona fide offer, or refuse to negotiate for the sale or rental of, or otherwise make unavailable or deny the dwelling or property to any person because of race, color, religion, or national origin. I recognize that any restrictive covenant on this property relating to race, color, religion, or national origin is illegal and void and any such covenant is hereby specifically disclaimed. I understand that civil action for preventive relief may be brought by the Attorney General of the United States in any appropriate U.S. District Court against any person responsible for the violation of the applicable law.

d. BUYER shall, however, have the privilege and option of proceeding with the consummation of this Contract, without regard to the amount of the appraised valuation of The Federal Housing Administration (Commissioner) or the amount of reasonable value established by the VA as the case may be. It is understood that the appraised value or certificate of reasonable value does not establish market value or sales price.

e. In the event that the FHA firm commitment or VA certificate of reasonable value as herein provided is not obtained within _____ days after the issuance of the mortgage commitment, then either party may cancel this Contract by giving notice of such intention mailed certified mail, return receipt requested, to the attorney for the other party, and upon so doing, the deposit made upon Contract shall be refunded to BUYER, and upon receipt of same by BUYER or BUYER's attorney, this Contract shall become null and void and all liabilities of the parties, one to the other, shall cease.

D. Existing mortgage clause.

BUYER assumes and agrees to pay according to its terms SELLER's mortgage, now a first lien on the premises, currently held by _____________, the principal balance of which is approximately $ ____________, bearing interest at the rate of _____% per annum and payable as follows: ___________.

E. Defects revealable by survey provisions.

1. . . . subject to any state of facts an accurate survey may show.

2. . . . subject to any state of facts an accurate survey may show provided the same does not render title unmarketable.

3. . . . subject to the facts shown on the survey made by ______________ dated __________ (and redated _________).

4. . . . subject to the facts shown on the survey made by ______________ dated __________ (and redated ________) and to any state of facts the said survey, brought down to date, would show, provided the additional facts that would be disclosed by reason of said survey being brought down to date do not render title unmarketable.

F. Easements, zoning ordinances, and restrictions.

1. General. . . . subject, however, to utility easements, zoning ordinances and restrictions of record providing there are no violations thereof. (List: tenancies, zoning ordinances, restrictions, liens, encumbrances, encroachments, easements, rights of way, special use of premises, and In Rem proceedings, if any.)

2. Utility Easements.

a. . . . subject to utility easements provided that the same are not violated by existing structures.

b. . . . subject to utility easements of record, but SELLER represents that all utility easements referred to herein do not affect any portion of the premises except within _________ feet of any rear or side line, and do not prohibit the construction, maintenance or reconstruction of any existing structure on the premises.

G. Zoning.

SELLER represents that the premises are presently zoned to permit _________________ and recognizes that such zoning is an inducement to BUYER to enter into this contract for an intended use as _________________. In the event that such zoning is changed prior to the closing of title hereunder, BUYER shall have an option to cancel this contract by written notice to SELLER, and thereupon all sums paid by BUYER to SELLER shall be promptly refunded and this contract shall be deemed canceled without any additional rights or obligations on the part of either party.

In the event that any hearing has been scheduled, or other action taken by any municipality prior to closing that contemplates any change in zoning or of the permitted use of the premises that may prevent or hamper the stated contemplated use by BUYER, the date of closing shall be adjourned until ten (10) days after final action has been taken on such contemplated change. In the event that final action is not taken by _____________, then this contract may be canceled at the option of either party by written notice to the other party and thereupon all sums paid by BUYER to SELLER shall be promptly refunded, and this contract shall be deemed canceled without additional rights or obligations on the part of either party.

Zoning regulations and ordinances of the city, town, or village in which the premises lie are not violated by existing structures.

SELLER represents that the existing structures and improvements on the premises and their present use as will conform in all respects with all applicable municipal zoning ordinances at the time of the closing of title hereunder.

H. Title objections.

If BUYER shall assert objections to the marketability of title (other than encumbrances to which title is subject), SELLER's attorney shall be given due notice thereof a reasonable time prior to the date set herein for the closing of title, and if necessary, SELLER shall have thirty (30) days to remove such objections, but shall not be compelled to bring any action or proceeding or to incur any expense in order to render title marketable. In the event such objections cannot be removed and as a result thereof, title shall prove unmarketable, as a condition precedent to the execution of this contract, it is agreed that the rights of BUYER and the liability of SELLER shall be limited to the following:

1. BUYER may elect to rescind this contract by giving due notice thereof to SELLER, who shall thereupon repay to BUYER the amount deposited hereunder plus BUYER's net actual disbursement for examining title (without policy issuing) and any commitment fee charged by the lending institution granting BUYER's mortgage application whereupon this contract shall become null and void and terminated with the same force and effect as if it had not been executed, and none of the parties, shall have any further rights, duties, claims, liabilities or obligations arising hereunder or in any manner from this transactions; or

2. BUYER may elect, by giving SELLER due notice thereof to accept such title as SELLER is able to convey, without abatement of the purchase price for defects, objections or encumbrances of title."

I. Termite inspection.

1. This Contract is conditioned upon BUYER being able to obtain a termite inspection report satisfactory to BUYER within ten (10) days after the signing of this Contract. In the event that BUYER shall fail to notify SELLER in writing of BUYER's inability to obtain a satisfactory termite inspection report within said ten (10) days, this

Contract shall remain in full force and effect and shall be unconditional. In the event that BUYER shall notify SELLER in writing that BUYER has obtained a bona fide termite inspection report which is not satisfactory to BUYER, then this Contract shall be deemed to terminate at BUYER's option and upon said termination SELLER shall immediately return to BUYER all sums paid thereunder.

2. An alternative is to substitute for the last sentence that if an unsatisfactory termite report is delivered to SELLER's attorney within the ten (10) day period, that SELLER will then have the option within five (5) days thereafter to notify BUYER that SELLER (i) will correct the condition at SELLER's expense prior to closing, or (ii) to cancel the contract and return the down payment, etc.

J. Building violations.

Violations in any county, city, state, or federal department which SELLER is required to remove hereunder shall not be an objection to title, provided SELLER shall deposit with SELLER's attorney, at or prior to the time of closing, a sum sufficient to perform the work and provide the material necessary to remove such violations, which sum shall not exceed $ ______, and shall agree to remove such violations within sixty (60) days from the date of closing title. In the event that the sum required pursuant to this paragraph shall exceed $ _____, the BUYER may elect, in his sole discretion, (a) to accept an appropriate reduction in the purchase price, or (b) to terminate and cancel this contract, in which event SELLER shall return to BUYER all moneys paid under this agreement, plus the net cost incurred by BUYER for examining title (including any survey made in connection with that examination), and neither party shall have any further obligation to the other.

K. Guarantees, certificates, and assurances.

1. Guaranty Against Defects in Construction

SELLER unconditionally guarantees the construction of the building:

a. against all defects of materials and workmanship of whatsoever nature for a period of one year expiring from the date of closing of title; and

b. with respect to the heating (and air conditioning) installations, that such installations will comply with the standards of performance set forth below in addition to being free from defects in materials and workmanship; the guaranty under this subdivision to endure for two years from the date of closing of title.

Standard for heating ____________________________.

Standard for air conditioning __________________.

The foregoing guaranties require SELLER to correct the substandard condition and not merely to pay money damages for breach of the guaranty. When SELLER is notified of a defect within the guaranteed period, SELLER's responsibility for corrective measures continues until the substandard condition no longer exists. SELLER shall be relieved from the foregoing guaranties only to the extent that: it receives an equivalent written guaranty covering the subject matter

of any item embraced above from the contractor who performs that item; and such guaranty is assignable and is assigned to BUYER; and the guaranty is not subject to any offset or counterclaim by the contractor that may be claimed against SELLER upon enforcement or attempted enforcement of the guaranty by BUYER.

No assignment of a contractor's guaranty shall relieve SELLER from liability on its own guaranty aforementioned accrued prior to such assignment.

2. Guaranty Against Assessments

SELLER guarantees that the premises shall not be subject to any assessment by the City or any other governmental subdivision by reason of any improvements (such as streets, sewers, curbs, or drains) that shall have been installed at the premises or the streets abutting the same at the time of the delivery of the deed hereunder. The provisions of this paragraph shall survive the delivery of the deed.

3. Guaranties of Construction

At the closing, SELLER will transfer and deliver to BUYER guaranties from SELLER's subcontractors of the roofing, plumbing, heating equipment, and electrical installation.

4. Plumbing and Heating Guaranty

SELLER guarantees the plumbing and heating system against defects in workmanship and materials for one year and that the heating system will have a capacity to heat the house at 70 degrees in zero weather.

5. Basement and Roof Guaranty

SELLER guarantees that the basement walls and the roof shall be free from water leakage for a period of one year after closing of title. This paragraph shall survive the delivery of the deed.

6. Streets, Sewers, etc.

SELLER represents that the street will be paved, sewers, curbs, and public utilities installed, all without charge or assessment to BUYER. This paragraph shall survive the delivery of the deed.

7. Dedication and Bond

SELLER represents that it has dedicated the streets abutting the premises to the City and that the City has accepted such dedication, subject to the completion of streets, sewers, drains, and curbs; and further,

8. Utilities

At the time of closing hereunder, SELLER will deliver a representation to BUYER to survive closing that sanitary sewers servicing the premises have been installed and sewer pipes connected therewith, all at SELLER's expense; that all utilities, including (but without limitation) water, gas, and electric, are available to service the premises and have been connected to the respective water, gas, and electric lines in the premises, all at SELLER's expense.

SELLER warrants and represents that, in connection with the aforementioned sewer lines and utilities, said lines and utilities run either from publicly dedicated streets to the premises or, in the event that they run through other private property, proper easements in recordable form exist covering the right to maintain and repair said lines and utilities.

L. Certificate of Occupancy.

Upon delivery of the deed and payment of the purchase price hereunder, SELLER will deliver to BUYER a Certificate of Occupancy issued by the local municipal or county housing code enforcement officer (or equivalent) and a certificate approving electrical and plumbing installation, if necessary, from licensed inspectors.

M. Notices.

Any and all notices hereunder sent by either party to the other shall be sent by certified mail addressed to the respective parties or their attorneys at the addresses given for them in this agreement, or delivered personally. Notices or receipts signed by the respective attorneys shall be deemed sufficient within the meaning of this paragraph without the signature of the parties themselves.

N. Personal property - apportionment or price.

The articles of personal property aforementioned which are attached or appurtenant to or used in connection with the premises are included in this sale and no part of the purchase price is attributed thereto as they have no separate value, except in conjunction with the real property described herein.

OR

It is agreed between the parties hereto that the consideration paid for herein in the sum of $ ________ shall apply to the purchase of the fee premises described herein and $ _______ shall apply to the personal property included in this sale. BUYER agrees to pay all required transfer or other sales taxes relating to the transfer of this personal property and BUYER is to execute at SELLER's request all necessary sales or transfer tax returns. A bill of sale to the personalty shall be delivered at closing.

O. Possession.

1. BUYER understands that SELLER is using SELLER's best efforts to purchase another home. In the event that SELLER shall have been unable to purchase such home and take possession thereof prior to the closing of title hereunder, SELLER may remain in possession of the premises under the closing of title until ______________ (at a rental of $ ______) (rent free).

2. In the event SELLER does not deliver possession of the entire premise to BUYER at time of closing as herein set forth, and by reason of the fact that the purchase price herein is being paid for both title to and possession of the within described premises and that failure by SELLER to deliver possession as hereinafter set forth shall result in a diminution of the purchase price, it is agreed as follows:

   a. SELLER is to deliver possession of the premises to BUYER not later than _____ day of ___________, 19____. SELLER shall deposit with SELLER's attorney on said date, or on the date of closing, whichever is sooner, the sum of __________ Dollars which is to be held by SELLER's attorney as security against the performance by SELLER of the portion of this contract requiring SELLER to vacate the premises and deliver possession thereof as herein provided.

   b. In the event that SELLER does not vacate said premises by said date, then the purchase price of the premises shall be reduced by the sum of $ _______ and such sum shall on said ____ day of ______________, 19___ be returned to BUYER on account of the diminution in the purchase price of the premises. For every day after the said day of ________________, 19___ that the possession of the premises is withheld, the purchase price of the premises shall be further reduced by the sum of ___________ Dollars for each and every such day and such amount shall be returned to BUYER as further diminution of the purchase price. Should the possession of the premises be withheld to a point beyond the date when the funds on deposit with SELLER's attorney shall be adequate to return the further diminished amounts of the purchase price of the premises, then SELLER shall pay such further sums directly to BUYER daily.

   c. That from on and after the date of closing of title to the premises herein, BUYER shall not be required or be obligated to furnish SELLER with any services, including heat or hot water nor make any alterations or repairs to the interior or exterior of said premises.

   d. The foregoing provisions shall survive the delivery of the deed.

P. Casualty loss.

1. If prior to the closing the property is damaged as the result of fire or other casualty, BUYER shall have the option to: (a) accept title to the Property without any abatement of the purchase price whatsoever, in which event at the closing all of the insurance proceeds shall be assigned by SELLER to BUYER and any moneys received by SELLER in connection with such fire or other casualty shall be paid over to BUYER; or (b) cancel this agreement, in which event the deposit shall be returned to BUYER by

escrowee and thereupon neither party shall have any further liability or obligation to the other. SELLER shall maintain adequate insurance on the property to cover the replacement value of the buildings and other improvements which are part of the property in case of any fire or other casualty occurring before the closing.

2. SELLER shall not settle any fire or casualty loss claims or agree to any award or payment in condemnation or eminent domain or any award or payment in connection with the change in grade or any street, road, highway, or avenue in respect of or in connection with the property without obtaining BUYER's prior consent in each case.

3. The risk of loss or damage to the Premises until the closing date by fire or other risk insured against is assumed by SELLER; however, should such loss or damage occur before the closing date, then SELLER may elect to assign to BUYER SELLER's rights under existing insurance policies (or any renewals or replacements thereof), in full discharge of all SELLER's obligations with respect to such loss or damage and in full satisfaction of all claims of BUYER by reason thereof. In such event, SELLER nevertheless may reserve all rights and claims for any loss of rents suffered up to the closing date, under the policies, if any, affording insurance of rents. Should the estimated damage exceed $10,000, then SELLER may elect to rescind this agreement.

Q. Condemnation.

If, prior to the closing, all of the property shall be taken by condemnation or eminent domain, this agreement shall be automatically canceled, the deposit shall be returned to BUYER, and thereupon neither party shall have any further liability or obligation to the other. If, prior to the closing, (a) less than all of the property shall be taken by condemnation or eminent domain; or (b) there is any taking of land lying in the bed of any street, road, highway, or avenue, open or proposed, in front of or adjoining all or any part of the land; or (c) there is any change of grade of any such street, road, highway or avenue, then BUYER may, at his option, cancel this agreement, in which event escrowee shall return to BUYER the deposit and thereupon neither party shall have any further liability or obligation to the other. If this agreement is not canceled, BUYER shall accept title to the property subject to the taking or change of grade, in which event at the closing the proceeds of the award or payment shall be assigned by SELLER to BUYER and any moneys theretofore received by SELLER in connection with such taking or change in grade shall be paid over to BUYER.

R. Assignment by buyer.

For value received, the within contract and all the right, title, and interest of BUYER thereunder are hereby assigned, transferred, and set over unto ________________ and said assignee hereby assumes all obligations of BUYER thereunder.

__________________ (BUYER) Dated: __________ 19___.

__________________ (Assignee of BUYER)

IV. CLIENT LETTER TO REVOKE TIME-SHARE PURCHASE.

Dear _________________:

Please be advised that, after careful consideration, I (my spouse and I) cannot afford to purchase the time share property that we agreed to purchase on _________. Also, I am currently in active military service and my frequent transfers deny me the opportunity to enjoy such an investment. Therefore, I do not intend to make further payments on this property.

Please return the $ ________ down payment I made minus expenses incurred in canceling this agreement. If this arrangement is not satisfactory, please advise me.

Sincerely,

(Signature block)

V. BINDER AGREEMENT.

Received from _________________ of _______________ as deposited on account of purchase price of premises located at: _______________________ on the following terms and conditions:

Terms: Purchase price is $ ________ payable as follows:

$ ___________ (including above deposit) on the signing of the formal contract as hereinafter provided.

$ ___________ by taking title subject to a first mortgage in that amount covering said premises, bearing interest at the rate of ___% per annum payable ____ annually, principal due ___________.

The balance of $ _________, payable in cash or certified check upon delivery of the deed.

Conditions: This deposit is accepted subject to owner's approval of the terms and conditions. If such approval is not obtained on or before five days from date hereof, this deposit shall be repaid to BUYER, but if obtained within such period a more formal contract in the form used by ____________ of _______________ shall be signed by the parties at the office of __________________ located at ___________________ at ______m., on ____________, 19___. The deed shall be delivered on the ____ day of ____________, 19___, at ____m. at the office of ______________________________.

Subject to following rights of tenants: ______________________

Subject also to the following: ______________________________

The parties agree that ___________________, as broker, brought about this sale and SELLER agrees to pay the usual brokerage commission.

This agreement may not be changed orally, but only by an agreement in writing and signed by the party against whom enforcement of any waiver, change, modification, or discharge is sought.

The above terms and conditions are approved and receipt of the above deposit is acknowledged.

____
Broker

I agree to the foregoing.

______________________ ______________________
Seller ***Buyer***

VI. RECEIPT.

Place: ______________________________

Date: ______________________________ 19_____

Time: ______________________________

Received from _____________, hereinafter called BUYER, the sum of ___________ DOLLARS ($ _______________), in consideration of which the undersigned, hereafter called SELLER, will, within ______ hours after the date and time of this receipt, meet with BUYER at ____________________________ and either sign a contract to sell to BUYER the property described in the unsigned sales contract attached hereto on the terms and conditions set out therein or, if SELLER elects not to do so, SELLER will refund to BUYER the amount received from BUYER plus an additional _________________ DOLLARS ($ ________________) as liquidated damages. If at the time and place named, BUYER fails or refuses to sign an appropriate sales contract on such terms, SELLER shall retain the amount for which this receipt is given as liquidated damages and shall not be further obligated to BUYER. If a sales contract for the property is hereafter entered into between BUYER and SELLER on any terms, the amount for which this receipt is given shall apply to the purchase price.

____
SELLER

____
BUYER

VII. OPTION TO BUY.

Place: ______________________________

Date: _______________________ 19____

Time: ______________________________

For and in consideration of the sum of ________ DOLLARS ($____________), receipt and sufficiency of which is hereby acknowledged, the undersigned, hereafter called SELLER, grants to ____________________, hereafter called BUYER, an option to purchase the property described in the unsigned sales contract and addendum attached hereto on the terms set forth in the attachment.

BUYER shall exercise this option by furnishing a notice to SELLER in writing that (s)he is ready, willing, and able, and does elect to purchase the property in accordance with the terms of the attachment.

The option shall expire ___________ hours after the date and time shown above.

If this option is exercised, the amount paid to SELLER for this option shall apply to the purchase price.

If this option is not exercised, the amount paid by BUYER hereunder shall be retained by SELLER.

____
SELLER

____
BUYER

Attach the UNSIGNED sales contract & addendum.

VIII. NEW CONSTRUCTION CONTRACT.

THIS NEW CONSTRUCTION CONTRACT entered into this ______day of ________________, 1992, by and between ____________________, hereinafter referred to as "Owner," and ______________________, hereinafter referred to as "Contractor."

WITNESSETH:

WHEREAS, the Owner presently owns, or will own, the property at ________________, further described in Exhibit A attached hereto and incorporated herein by reference (the "Property"); and

WHEREAS, the Owner desires for the Contractor to build a home on said property as defined hereinafter;

NOW THEREFORE, in consideration of the mutual promises, covenants, and agreements, the parties hereto do hereby contract and agree as follows:

1. **Construction by Contractor.**

(a) The Contractor does hereby agree to build for the Owner the home located upon said Property of the Owner, in accordance with the plans and specifications, marked Exhibits B and C respectively, attached hereto and incorporated herein by reference. The Contractor shall construct all improvements on the Property in a manner agreeable to Owner.

(b) The Contractor, upon the execution of this contract, will proceed with construction and will complete said construction on or before _______________. Time is of the essence to the Owner. A penalty of $100.00 per day will be paid by Contractor for each day beyond ______________ that the work pursuant to this contract is unfinished.

(c) The Contractor further agrees to build said house in a first-class, workmanlike manner and to deliver the finished construction to the Owner as a "turn-key" job, with the exceptions, if any, noted in the specifications.

(d) The contractor will not make any changes in the plans or specifications without the prior written approval of the Owner. All changes in the plans and specifications will be evidenced by change orders duly signed by the Owner and the Contractor. All change orders will designate the dollar amount of credit or debit to be applied against the hereinafter stated construction price. The specifications call for certain allowances. Differences in the allowances shall be debited or credited against the construction price.

2. **Licenses & Permits for Construction:** The Contractor shall be responsible for the cost of all licenses, building permits, and utility costs required for completion of the work

under this contract, including furnishing the appropriate utilities to the job site, including all meters and underground electrical service.

3. **Construction Insurance:** The Contractor shall at its own cost and expense procure and maintain insurance required under the Workmen's Compensation Law, as well as public liability insurance and full value builder's risk insurance on the premises.

4. **Payment by Owner:**

(a) The Owner shall pay the Contractor for the performance of this contract the sum of __________________ payable at the times and subject to the conditions imposed by Owner's lender. Contractor agrees to subordinate any lien it may have against the Property to the lien of any permanent financing that Owner has obtained on the Property and to cause its subcontractors to do the same.

(b) In addition to any requirements imposed by Owner's lender, at the time of each draw Contractor shall furnish Owner statements showing expenditures to date, items due and unpaid, and will support such statements with receipted bills, affidavits, and waivers of lien sufficient to bar the assertion of a lien against the premises by any party in connection with the work performed or materials furnished under this contract.

(c) At time of final payment, Contractor shall deliver to Owner a complete release of all liens arising out of this contract sufficient to bar the assertion of a lien against the premises by any party in connection with the work performed or materials furnished under this contract, and an affidavit that the release and receipts include all labor and material for which a lien could be filed.

5. **Failure to Perform:**

(a) OWNER: Subject to the provisions of paragraph 5 (c), and as long as Contractor has not breached its obligations hereunder, in the event that the Owner fails to pay the Contractor any of the progress payments provided for by Owner's lender, then the Contractor may upon fourteen (14) days written notice to the Owner, stop work or terminate this contract and recover from the Owner payment for all work executed and any and all materials purchased including reasonable profit on said work and materials.

(b) CONTRACTOR: Subject to the provisions of paragraph 5 (c), if the Contractor should neglect, in the prosecution of said work, to perform any provision of this contract, the Owner may upon fourteen (14) days written notice to remedy said failure to perform this contract in said respect, and upon neglect of the Contractor to comply with said notice the Owner shall be entitled to remedy such deficiency and deduct the cost thereof from any payment then due or thereafter becoming due to the Contractor. Provided, however, upon the failure of said Contractor to remedy any deficiencies in the performance of this contract as last mentioned, the Owner shall at his sole option be entitled to terminate the employment of said Contractor under this contract, and for that purpose to enter upon the premises where said work is being done and to take possession thereof for the purpose of completing the work specified under this contract and to employ other persons to complete said work, and to provide materials therefor; and, in the event last specified, if the expense incurred by the Owner in completing the work shall

exceed any such unpaid balance then due, the Contractor shall pay the deficiencies to the Owner; but, in the event that the expense shall not exceed the unpaid balance, then the Owner shall pay the difference to the Contractor.

(c) RESOLVING DISPUTES: If any dispute should arise between the parties hereto concerning the quality or quantity of work performed by the Contractor during construction, then and in such case, the parties hereto do hereby agree to employ an architect or other qualified person agreed upon by the parties to inspect the premises and make all final decisions between the parties as the matters in controversy. The cost of said architect or other person shall be borne equally by both parties. In the event the parties are unable to agree on an architect, then they each shall select an architect and the two architects together shall select a third. The agreement of any two of the architects thus selected shall be binding on the parties hereto. Each party shall pay the expenses of the architect they select and the parties shall bear equally the expense of the third architect.

6. **Indemnification of Owner:** The Contractor shall indemnify and save harmless the Owner from all loss, cost, or damage on account of injuries to persons or property occurring in performance of this contract, together with any and all attorneys fees incurred by the Owner on account of any thereof.

7. **Warranties:**

(a) The Contractor will warrant all construction including materials for a term of one (1) year from the date of final acceptance. The Contractor shall remain responsible for any defects in the improvements caused by design errors.

(b) The Contractor will commence and proceed with due diligence to repair, replace, correct, and adjust any and all materials and workmanship which may need correction within ten (10) days from the receipt of either written or verbal notice from the Owner.

(c) The Contractor will deliver to the Owner upon acceptance of the completed construction all warranties issued by manufacturers for heating, air conditioning, appliances, roofing, and all other materials and equipment purchased under warranty.

8. **Bankruptcy:** If during the progress of the work under this contract, the Contractor should be adjudged bankrupt, or if it should make a general assignment for the benefit of its creditors, or if a receiver should be appointed on account of its insolvency, the Owner may terminate the employment of said Contractor under this contract.

9. **Delays Attributable to Owner:** If the Contractor is delayed at any time in progress of work by any act or neglect of the Owner, or by any other contractor employed by the Owner, or by changes ordered in work, or by fire, unusual delay in transportation, unavoidable casualties or any causes beyond the Contractor's control, or by delay authorized by the Owner pending arbitration, or by any cause which the Owner shall accept as justifying the delay, then final completion shall be extended for a reasonable time justified by the delay.

10. **Compliance of Construction with Applicable Law:** The Contractor agrees to verify that the Property described on Exhibit A and the construction thereon will comply with all applicable laws, rules, and regulations, including, but not limited to, the applicable building code and zoning and subdivision laws, rules, and regulations.

13. The Contractor and Owner for themselves, successors, executors and administrators hereby agree to the full performance of the covenants herein contained.

IN WITNESS WHEREOF, they have executed this contract the day and year first above written.

OWNER:

__________________(SEAL)
Owner

CONTRACTOR:

____

By ________________________ President

(Corporate Seal)

ATTEST:

_________________________ Secretary

CHAPTER 4

DEFAULT AND FORECLOSURE

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I. INTRODUCTION.

This chapter will explore some of the considerations raised by the failure to pay installments on a mortgage secured loan. The failure to pay monthly mortgage installments raises a number of personal, financial, and legal considerations. The most drastic consequence of nonpayment is that it may result in the ultimate loss of shelter. Similarly, while the home may have been purchased with the intent that it also serve as an investment vehicle or a hedge against inflation, default in payment may ultimately lead not only to a loss of any equity, but also responsibility for some further amount.

Section II of this chapter will give a general overview of the mortgage practices and procedures for addressing an uncured default in making payments when due. Section III will address factors to be considered in the attempt to save the home and avoid foreclosure. The fourth section will discuss rights and remedies a soldier may have during foreclosure. The fifth section will address measures to avoid a deficiency judgment. The final section will discuss foreclosure of Veterans Administration guaranteed loans.

The question of mortgage foreclosure may arise in two distinct ways in legal assistance practice; nonpayment by the soldier or spouse on a currently owned and occupied home or default by a subsequent purchaser on an assumed mortgage. This second pattern occurs when there is a default in payment by the purchaser of a home previously owned by the soldier who, as seller, was not released from his personal liability on the debt or the VA guaranty with respect to the financing obtained when he originally purchased or owned the home. Section V will discuss some of the considerations involved with default of an assumed loan by a subsequent purchaser.

State law generally sets forth the rights and responsibilities of creditors and debtors as well as the procedures to be followed in enforcing them. In some states, there will be significant variations in the practices and procedures applied in different counties. Accordingly, legal assistance attorneys should refer soldiers to local attorneys to determine the particulars of local law and practice.

Additionally, federal legislation may come into play. For example, there are provisions for a mortgagor to get a moratorium on principal, interest, and taxes under FHA or VA mortgages where employment is terminated due to base closings. In the case of mortgages originated before the soldier entered military service, the Soldiers' and Sailors' Civil Relief Act may limit the actions the mortgagee may take.

II. OVERVIEW OF FORECLOSURE LAWS.

The most common procedure used to enforce the creditor's security interest in the real property upon default of the purchaser is judicial foreclosure. The foreclosure concept relates to the original security form used five centuries ago: a deed from the borrower to the lender subject to a condition subsequent; namely, the payment by the borrower of the full amount due on or before a specified date which was called "law day." If the debtor failed to pay by law day, the condition subsequent failed and the property forfeited to the creditor. Mortgagors who failed to pay the underlying debt on law day, but who were ready, willing, and able to perform shortly

thereafter, petitioned Courts of Chancery for relief from the harsh results of forfeiture. Courts devised the practice of allowing a fixed period of time after law day during which the borrower could redeem the property by repayment of the underlying debt. This remedy was called the mortgagor's "equity of redemption." If, however, by the end of the period set by the court the mortgagor had still not paid the underlying debt in full, then the equity of redemption was "foreclosed," or lost forever.

Judicial foreclosure is the modern version of this practice. It is a proceeding initiated by the mortgagee after the mortgagor has defaulted in performance required by the mortgage on the underlying note or other instrument evidencing the debt. The default in making an installment payment before the expiration of a specified grace period usually permits the mortgagee's acceleration of the remaining installments. Mechanically, the failure to pay an installment within the grace period specified in the underlying debt instrument authorizes the holder to accelerate the due date on the remaining installments. This normally requires notice to the debtor that the remaining installments have been accelerated and a demand that the unpaid balance be paid within a specified time, after which the loan and mortgage are in default. Normally, the installments are not accelerated unless the mortgagee has decided to proceed with foreclosure.

Almost every state provides for judicial foreclosure. Under this method, the mortgagee brings court action for a court-ordered sale of the mortgaged property after sale. It is the primary method of foreclosure in at least half of the states. The typical action is quite lengthy and includes a number of protections for the mortgagor, including the right to notice, an opportunity to be heard, notice of sale, proceedings for determination of right to surplus, and entry of a deficiency decree.

Another method of foreclosure, recognized in only six states, is strict foreclosure. Under strict foreclosure, the mortgagee follows a procedure to judicially terminate the mortgagor's equity of redemption and become the owner of the land in satisfaction of the mortgage debt. No sale of the underlying property is required. Most states that recognize strict foreclosure give a mortgagor time in which to redeem. Mortgagees that have elected strict foreclosure are usually not allowed to pursue a deficiency judgment.

Another more common method of foreclosure is the "power of sale" foreclosure, which permits sale of the encumbered property without judicial action. Although most states allow foreclosure by power of sale, the procedure varies widely from state to state. Power of sale foreclosure eliminates many of the judicial and procedural burdens of judicial foreclosure. Nevertheless, a mortgagee must strictly comply with statutory procedural requirements. States recognizing power of sale typically require notice of the sale to the debtor and protected parties and a waiting period between the date of the notice and sale.

A power of sale foreclosure is predicated upon a provision in the underlying mortgage or deed of trust granting to the creditor the power to sell the property upon the occurrence of the events constituting the default. Commonly, the mortgagee is precluded from bidding on the property, although this may be avoided by having the property transferred to a trustee and accepting back a deed of trust.

States permitting power of sale foreclosures also statutorily regulate the procedure for conducting the actual foreclosure sale. States which allow power of sale foreclosures generally

require strict compliance with procedural requirements, and noncompliance will furnish grounds for setting aside a power of sale foreclosure.

Often, the foreclosure action will not generate enough money to satisfy the total indebtedness. A mortgagee is generally entitled to recover the balance of the loan by obtaining a deficiency judgment. Typically, this is obtained by a deficiency decree by the court supervising the foreclosure action.

Soldiers facing a deficiency after foreclosure may be able to take advantage of "anti-deficiency" legislation passed by many states that impose limits on mortgagees. While most states with judicial foreclosure statutes allow deficiency judgments, many limit recovery in some way. For example, some states prohibit deficiency judgments if the property being foreclosed upon was secured by a purchase money mortgage. Three states recognizing power of sale foreclosure specifically prohibit deficiency judgments following a power of sale. Moreover, eight states limit recovery in the deficiency action to no more than the difference between the mortgage debt and the value of the mortgaged property.

Most states require a number of strict procedural requirements for obtaining deficiency judgments. Failure to comply with these requirements can provide grounds for invalidating the judgment. While mortgagees often seek to add waiver language to their mortgages, these may not be effective. Since the benefits of anti-deficiency legislation are defeated if the mortgagor waives the protections of the law, courts and states have taken steps to prevent waivers.

Many states allow mortgagors the right of statutory redemption following judicial or power of sale foreclosure. This procedure gives the mortgagor a grace period to redeem the mortgaged property after a foreclosure sale. The redemption periods vary greatly, from ten days in North Carolina to three years in Rhode Island.

Statutory redemption rights vary among the two dozen or so states which have adopted them in some form, but tend to follow the same general pattern. The right arises with the sale of the property at auction (in the case of a judicial foreclosure) or its transfer to the mortgagee (in the case of strict foreclosure) and ends at the expiration of the time specified in the operative statute. Strict compliance is commonly required of the person attempting to redeem the property.

The foreclosure procedure for Department of Housing and Urban Development (HUD), Federal Housing Administration (FHA), and Department of Veterans Affairs (VA) backed loans are generally the same as for the conventional financing with some differences worth noting. The HUD starts with the proposition that foreclosure is a last resort which should not be initiated until all other actions calculated to service the debt have been exhausted. The debtor has to be contacted and personally interviewed prior to the occurrence of three months during which he has failed to make the full payment due. Further, under the HUD definitions, the failure to perform a covenant under the mortgage, such as the covenant to pay monthly installments, does not constitute a default unless and until it exists for a period of 30 days.

A number of procedural safeguards apply upon the default of a VA-guaranteed loan to fully protect the interests of the VA and the other parties involved. Holders are required to provide timely notice to the VA upon the default of any guaranteed loan. The holder of a VA-guaranteed loan may not take action to terminate the debtor's rights on the property until after the expiration of 30 days from delivery of notice to the VA of intention to take action.

After receipt of the notice, the VA has the right to either pay on its guarantee and be subrogated to the rights of the lender to that amount or pay the unpaid balance of the loan and receive an assignment of the loan and security interest. These discretionary provisions are designed for the benefit of the VA, not the veteran, and are not subject to judicial review. Accordingly, the veteran cannot compel the VA to pay the mortgagee the unpaid balance and take assignment.

The holder of a VA-guaranteed loan must also provide notice to the Administrator before commencing legal action or beginning foreclosure proceedings. The VA has 30 days to decide whether to pay the holder the unpaid balance of the obligation and receive an assignment. If the holder commences legal proceedings to foreclose on the loan, it must provide copies of all documents and pleadings to the VA. Copies of notice of sale under a power of sale must be furnished to the VA at least 15 days prior to sale. During this time, the Administrator may inform the holder how it should proceed to preserve the personal liability of the parties. Failure to comply by the holder relieves the VA of its obligations under its guaranty.

Upon receipt of notice of judicial sale or sale under power of sale, the VA has the right to specify a minimum bid price. If the foreclosure sale does not generate a selling price sufficient to satisfy the amount of the loan, the VA will pay the lender the difference between the selling price and the amount of the loan up to the amount of the loan guaranty. After payment of the guaranty amount, the VA is subrogated to the contract and the rights of the holder to the extent paid. The VA has two alternatives to recover money paid under the guaranty. First, it may pursue any causes of action the lender had against the veteran under a subrogation theory. Second, the VA may proceed directly against the veteran for the amount paid on the guaranty pursuant to an independent right of indemnification.

The statutory and regulatory provisions give the VA extensive rights upon default of a guaranteed loan. The VA in most cases will have the option of selecting foreclosure methods by means of subrogation to the holder's rights, taking assignment of the loan and the security, or providing direction to the holder on how to proceed.

One alternative open to the VA available upon default when the veteran is still in possession is known as "refunding." Under this procedure, the VA, prior to commencement of foreclosure proceedings, pays the lender the unpaid portion of the veteran's loan and the lender assigns its interest and security in the loan to the VA. The veteran then makes monthly payments directly to the VA until the loan is satisfied. The veteran must be able to establish his ability to repay the loan, and the VA's decision not to refund a loan is not judicially reviewable.

III. OPTIONS AVAILABLE UPON DEFAULT.

A. Curing the Default

Soldiers encountering financial difficulties should immediately seek financial counseling to determine if repayment of the loan is possible. The reasons for the default should be isolated to determine whether curing the default will solve the problem. If the cause of the default is a temporary situation -- such as unforeseen and uninsured medical expenses of less than

catastrophic amounts -- then the inability to pay the mortgage secured loan may well be viewed as a temporary cash flow problem.

In many cases, soldiers can avoid default merely by cooperating with the lender. If the number of payments missed is not great and the soldier is confident that he can both carry the monthly installments plus pay down some part of the payments missed, a workout schedule may be the simplest, cheapest, and best solution for all concerned. This, of course, will require the forbearance and cooperation of the holder of the mortgage. The holder will take into account the soldier's credit worthiness at the time as well as the value of the home and the various market conditions previously discussed. Further, the holder must be assured by the payout schedule proposed that the soldier can continue the installments and make up the missed payments as promised. The rate charged on the delinquent payments may be higher than that under the mortgage indebtedness.

Several factors will come into play in determining whether a workout agreement will be acceptable. The soldier must recognize that the more attractive the mortgage is to him the less attractive it is to the holder of the indebtedness and mortgage. Accordingly, if the indebtedness carries an interest rate below the prevailing interest rate, the holder will be less inclined to a resolution which allows the below market rate loan to continue, especially if either the outstanding balance or the number of remaining installments is substantial. Similarly, any other particular feature about the loan which makes carrying it more or less attractive to a holder may affect whether the holder will endeavor to work out the missed payments and allow the loan to be carried until the installments are made current.

The identity of the holder of the indebtedness and the mortgage may also determine the attractiveness of a workout arrangement. The holder may be a bank, a savings and loan association, a credit union, an insurance company, a real estate investment trust, or a private individual. Even though the holder is a bank or a savings and loan association, that does not mean that the mortgage and debt are held by the entity that originated the loan. If the holder is a financial institution, the decision to continue or refinance the loan rather than foreclose may well depend upon the holder's own financial situation and how many other non-performing loans are being carried. The institution may well be under conflicting pressure from federal agencies which want holders to treat foreclosure as a last resort measure and bank regulators who seek to reduce bank exposure. The stronger the bank, the better may be its position to ride out a temporary situation. Conversely, the weaker the bank, the less it can afford the risk of carrying yet another nonperforming loan.

Conditions in both the money and real estate markets may also affect the alternatives available. Prevailing interest rates may limit the attractiveness of any alternative based upon continuing the current loan with an interest rate at a lower rate. Lower market rates, on the other hand, make refinancing a more attractive option for the soldier. Similarly, a real estate market with rising prices might comfort the bank or other holder of the indebtedness and mortgage into believing that the amount to be realized upon a foreclosure sale would be enough to satisfy the unpaid balance. As long as the market continues to increase the value of the net equity, the holder may see his risk and loss being limited to the timing of his return without jeopardy to either principal or interest. If, on the other hand, real estate prices are decreasing at the time, the holder may fear that the balance owed can only increase with time, while the net amount

recoverable from the realty securing the loan may be decreasing. This means his actual risk of loss increases with time and may in the future include loss of principal as well as interest.

Soldiers with VA loans in default should seek financial counseling from the nearest VA regional office. Although the VA does not provide legal advice, financial counseling is available to assist veterans facing default. Procedures added in 1987 require the VA to contact the veteran upon receipt of notice of default and provide information and, to the extent possible, counseling to the veteran. The VA is required to advise the veteran about alternatives to foreclosure, possible means of curing the default, and the rights and liabilities of the VA and the veteran in the event of default.

Even if the holder is unwilling to agree to a workout, financially stable soldiers with VA loans may be able to convince the VA to take over the loan from the lender under the refunding program.

B. Selling the Home.

Soldiers who cannot make their required payments should attempt to avert foreclosure by selling the mortgaged property themselves because foreclosure sales rarely generate enough proceeds to satisfy the total indebtedness. Unless the property has depreciated in value since purchase, the soldier should be able to recover enough from the sale to repay the loan in full and avoid the negative consequences associated with foreclosure. Soldiers should not, however, convey property before obtaining legal advice because there have been a number of real estate "scams" that prey on soldiers who have defaulted on their loans. It is always good practice for the soldiers to notify the holder and the VA, for a VA-guaranteed loan, of any impending sale or other transfer. For VA loans closed after 1988, the lender and the VA must approve any sale or other assumption of a VA-guaranteed loan.

A VA loan compromise program may provide some soldiers with VA-guaranteed loans an opportunity to substantially reduce or eliminate financial losses associated with loan terminations. The theory behind the compromise agreement program is that all parties involved benefit when a veteran avoids loan foreclosure by selling the property. To encourage the sale of mortgaged property, the VA will refinance the amount of the loan balance remaining after the sale of the home.

The compromise agreement should be considered when, as a result of a decline in real estate values, a soldier is unable to sell a home for a price sufficient to cover the amount of a loan balance. The program may also be used when delinquent payments increase the loan balance above the fair market value of the property. To participate in the program, the veteran must find a buyer willing to purchase the property for its fair market value. The selling price must also be less than the outstanding balance on the original loan. A copy of the sales contract, a recent property appraisal, and other documents should be submitted to the VA, along with a request to enter into a compromise agreement. If the VA approves the request, it will pay all or part of the remaining balance and finance all or part of the balance. The veteran must agree to remain liable for the amount of the claim the VA is required to pay the lender. The new debt can be financed for up to 30 years at an interest rate as low as 4%. Once this debt is paid off, the veteran's VA loan eligibility will be restored.

C. Avoiding Foreclosure.

In every jurisdiction, mortgagors have the right, after default, to perform their obligation under the mortgage and have title to the property restored. Historically, courts have scrupulously protected the mortgagor's rights of redemption against attempts to limit or curtail the right. To take advantage of these redemption rights, however, mortgagors must generally pay the entire amount of the mortgage debt.

Mortgagees will usually resort to foreclosure proceedings to terminate the soldier's right of redemption. The acceleration clauses found in most modern mortgages give mortgagors the power to declare the entire mortgage debt due and payable. A soldier may be able to defeat a mortgagee's right to acceleration by arguing that the mortgagee has shown a consistent pattern of accepting late payments. A number of states have recently enacted "arrearages" legislation that will allow a mortgagor to defeat acceleration by paying the default that existed prior to acceleration. Ten states have statutes that allow a mortgagor an opportunity to pay all present and future installments due and thereby avoid foreclosure. Under these reinstatement statutes, a soldier may be able to avoid acceleration of the loan and an ensuing foreclosure suit.

Soldiers who are unable to sell their homes may be able to convince the lender to accept a deed in lieu of foreclosure. This procedure is recognized in almost every state and will completely release the soldier from liability on a loan. In some areas, local custom permits the homeowner to give the mortgagee a deed in lieu of foreclosure in full satisfaction of the debt. In other jurisdictions, the same results are reached by the homeowner waiving post-foreclosure rights to redemption. The debtor's right to redeem the property has a substantial negative impact upon the price to be realized at the foreclosure sale because the buyer will not know with certainty that he will keep the property until the redemption period has expired. The waiver of the right of redemption, like the deed in lieu of foreclosure, gives the lienholder a better, more certain title to convey which should positively affect the amount ultimately received for the property.

The VA has a longstanding policy of encouraging holders to accept a voluntary conveyance in lieu of foreclosure because it saves liquidation expenses and time. This procedure is, however, discretionary for the VA and will be approved only if it is in its best interest. One disadvantage of offering a deed in lieu of foreclosure is that it may generate increased federal income tax liability for the veteran to the extent of the loan forgiveness.

IV. RIGHTS DURING FORECLOSURE.

A. Rights Under State Law.

A soldier may be able to successfully defend a foreclosure suit or action on a deficiency after foreclosure by taking advantage of provisions of state or federal law. Most state laws continue the historical trend of protecting mortgagors from mortgagees and avoiding forfeitures. Thus, the laws in many states impose strict procedural requirements on mortgage foreclosures, specify limited avenues for foreclosing on secured property, and curtail the ability of mortgagees to bring actions to recover deficiencies after foreclosure. Soldiers with property being judicially

foreclosed may be able to maintain that they were not given adequate notice, or, in the case of assumed loans, were not joined as a necessary party. A foreclosure action will not terminate the right to redeem of any party who was not given notice of or who was omitted from the proceeding.

Soldiers may also be able to maintain that the method of conducting a foreclosure sale was improper. Although state and local laws differ greatly on the procedures to be followed, most jurisdictions have elaborate statutory protections designed to encourage fair sales prices and avoid transfers that are well below the value of the property.

Veteran-mortgagors, like holders of other federally guaranteed mortgagors, have attempted to use state laws to defend against foreclosure and deficiency actions brought by the VA. In seeking to recover guaranty payments against veterans, the VA has two options. The VA may pursue whatever actions the lender may have against the veteran as a subrogee.[1] In that situation, the VA must comply with all applicable state laws since they are standing in the shoes of the private lender.[2] The situation is less settled when the VA pursues its independent rights under the indemnity agreement with the veteran.[3] Federal agencies, seeking to enforce their elections as to foreclosure and indemnity, have asserted a variety of arguments, usually with success, that the state law requirements for foreclosure are preempted by federal regulations implementing the various guaranty programs. Enough courts find against the agencies that the body of law in this area is somewhat chaotic.[4]

The concept of preemption asserted by the federal agencies is a longstanding one, finding its origin in *Clearfield Trust Co. v. United States*.[5] While *Clearfield Trust* did not involve real property,[6] it established the principle that there was a federal common law which preempted a state law requirement with regard to the collection of a debt. In deciding that case, the U.S. Supreme Court stated that "[t]he application of state law, even without the conflict of laws rules of the forum, would subject the rights and duties of the United States to exceptional uncertainty.

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[1] 38 C.F.R. § 36.4323(a).

[2] *See, e.g., Boley v. Brown*, 10 F.3d 218, 220-22 (4th Cir. 1993).

[3] 38 C.F.R. § 36.4323(e).

[4] *See* Patrick A. Randolph, Jr., *The Future Of American Real Estate Law: Uniform Foreclosure Laws And Uniform Land Security Interest Act*, 20 NOVA L. REV. 1109 (1996); Frank S. Alexander, *Federal Intervention In Real Estate Finance: Preemption And Federal Common Law*, 71 N.C. L. REV. 293 (1993).

[5] 318 U.S. 363 (1943).

[6] *Clearfield Trust* involved a check that was intercepted in the mail, forged, and cashed. Clearfield Trust was the bank that presented the check to the Federal Reserve for payment. Under state law, the victim of the forgery (in this case, the government) was required to give timely notice to the bank in order to recover. The government had failed to give this notice in a timely fashion. Thus, the result of the case hinged on which law applied. *Id.* at 364-66.

It would lead to great diversity in results by making identical transactions subject to the vagaries of the laws of the several states."[7] These principles of federal common law and the desirability of uniform results were extended to a mortgage transaction in *United States v. View Crest Garden Apartments, Inc.*,[8] where a Circuit Court applied the *Clearfield Trust* holding to an FHA mortgage transaction.

By the early 1960s, it seemed that the debate was settled in favor of totally preempting state law mortgage remedies when the federal government was acting as the holder of the mortgage.[9] Particularly with regard to the Veterans Administration, the issue had apparently been considered and decided in favor of preemption. In *United States v. Shimer,*[10] the U.S. Supreme Court considered whether the VA should be bound by the Pennsylvania Deficiency Judgment Act, which limited a mortgagee from recovering in a deficiency judgment unless the mortgagee obtains a court determination of fair market value of the mortgaged property. The Court held that, even though the VA failed to obtain the required court determination under state law, application of the state law in this context would be inconsistent with VA regulations which grant a right of indemnity to the VA.

In 1979, the U.S. Supreme Court planted the seeds for potential erosion of the federal preemption position with its decision in *United States v. Kimbell Foods, Inc.*[11] Like *Clearfield Trust, Kimbell* was not a real property case. It did, however, establish principles that were later applied to mortgage transactions. *Kimbell* reaffirmed the general proposition that federal law always applies when the government was independently foreclosing on a lien. The Supreme Court found, however, that in certain cases, lower courts should adopt the state law as the federal rule. The case set forth a three-part test to determine when this action was appropriate. This test has been summarized by a commentator as follows: "(1) Is the nature of the federal program such that a nationally-uniform rule is needed? (2) Would the application of the state rule frustrate specific objectives of the federal program? (3) Would application of a federal rule disrupt commercial relationships which are predicated on state law?"[12] This rule, while not created in a situation where the security interest was in real property, has since been applied to mortgage transactions.[13]

Specifically regarding VA loans, however, it is still fair to say that most jurisdictions follow the rationale of *Shimer*, and find that there is a federal common law which permits the VA

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[7] *Id.* at 367.

[8] 268 F.2d 380 (9th Cir. 1959).

[9] *See* G. NELSON & D. WHITMAN, REAL ESTATE FINANCE LAW § 11.6 (2d ed. 1985).

[10] 367 U.S. 374 (1961).

[11] 440 U.S. 715 (1979).

[12] NELSON & WHITMAN, *supra* note 9, at 818.

[13] *See id.* at 819-823.

to seek its independent rights under the indemnity agreement against mortgagors despite the existence of inconsistent state law. For example, in *Jones v. Turnage,*[14] the court held that California's anti-deficiency law did not bar the VA from seeking indemnity against a veteran for the amounts the VA paid under its loan guaranty. The court agreed with the VA that a nationally uniform law would serve the national interest and avoid subjecting the loan guaranty program to the "vagaries of the various state laws which might control."[15] The Fifth Circuit reached a similar result in holding that Florida law barring anti-deficiency suits did not apply to the VA.[16] The Fourth Circuit also ruled that the state foreclosure law did not affect the VA's statutory indemnity rights.[17]

A few courts, however, have shown a tendency to require the VA to comply with state foreclosure law when pursuing its election to foreclosure and indemnification. In *State v. Whitney,*[18] the court held that VA regulations governing mortgage foreclosure did not displace New York state law requiring notice to mortgagors. Accordingly, the court ruled that the VA could not recover a deficiency from the mortgagor on either a theory of subrogation or indemnity because it elected to proceed under state foreclosure law, but did not provide notice to the mortgagor as required under state law. The Court of Veterans Appeals has also recognized that lack of a good faith attempt to provide notice to the veteran constitutes a defense to any attempt to recover a deficiency.[19] Similarly, in *United States v. Vallejo,*[20] a federal court held that the VA was barred from bringing a deficiency suit against a veteran because it elected to pursue foreclosure under power of sale and state law prohibited deficiency judgments following this action.

These cases, and others like them, create a colorable claim that state rules should apply to the VA, even when it is pursuing its independent indemnity rights. While the majority of

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[14] 699 F. Supp. 795 (N.D. Cal. 1988), *aff'd sub nom, Jones v. Derwinski*, 914 F.2d 1496 (9th Cir. 1990). This decision should be compared with *United States v. Stewart*, 523 F.2d 1070 (9th Cir. 1975), where the court held that the California anti-deficiency statute barred a VA deficiency claim when the agency foreclosed on a direct loan.

[15] *Id.* at 802, *citing United States v. Wells*, 403 F.2d 596 (5th Cir. 1968).

[16] *United States v. Wells*, 403 F.2d 596 (5th Cir. 1968). *See also United States v. Spears*, 859 F.2d 284 (3rd Cir. 1988) (Farmers Home Administration need not comply with two Pennsylvania statutes setting forth procedural rights for mortgagors).

[17] *Boley v. Brown*, 10 F.3d 218 (1993).

[18] 602 F. Supp. 722 (W.D.N.Y. 1985).

[19] *Buzinski v. Brown*, 6 Vet. App. 360 (1994).

[20] *United States v. Vallejo*, 660 F. Supp. 535 (W.D. Wash. 1987).

jurisdictions seem to favor preempting state law requirements in this situation, veterans should not overlook potential remedies that might be available under state law in their jurisdiction.

B. Rights Under Federal Law.

Although foreclosure and deficiency actions will be brought within the framework of state law, federal law may provide certain remedies to veterans. These remedies or defenses might stem from constitutional guarantees of due process or specific federal statutes, such as the Soldiers' and Sailors' Civil Relief Act (SSCRA) and the Bankruptcy Code.

A mortgagor may set aside a foreclosure action if the action did not satisfy minimal standards of due process required under the fifth or fourteenth amendment. Since these amendments regulate governmental, not private activity, a prerequisite to making this constitutional attack is to establish the existence of state action. The Supreme Court has never adequately defined the state action requirement and lower Federal courts have not reached a consensus on the issue.

The early view adopted by most courts was that constitutional due process rights are not implicated if foreclosure action is brought by the lender, even though a governmental agency has been extensively involved. In *Fitzgerald v. Cleland*[21] a federal court held that the fifth amendment is not implicated when a bank assigned its interest in mortgaged property to the VA after initiating foreclosure action. In the court's view, extensive governmental regulation is not enough to trigger constitutional due process rights; rather, there must be a close nexus between the VA and the lender so that the lender's actions can be considered those of the VA.

Recently courts have shown a willingness to find the requisite federal action in cases involving the VA. In *United States v. Whitney*,[22] the court intimated that VA's use of judicial foreclosure in state court was sufficient to trigger the protections of the due process clause. Moreover, the court ruled that the acts and omissions of the VA which led to the denial of the veteran's rights of due process of law and adequate notice clearly constituted "state action" sufficient to implicate the fifth amendment due process clause.[23]

In *United States v. Murdock*,[24] another Federal court held that a veteran was entitled to proper notice of a foreclosure action seeking to extinguish the veteran's property right in the equity of redemption. Although the court did not address the state action issue, it is implicit in the holding that the court considered the VA's involvement in the foreclosure action sufficient to implicate procedural due process protections. In light of *Whitney* and *Murdock* one may conclude that requisite federal action is present when the VA is bringing the foreclosure action.

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[21] 498 F. Supp. 341 (D. Me. 1980), *aff'd in part and vacated in part*, 650 F.2d 360 (1st Cir. 1981).

[22] 602 F. Supp. 722 (W.D.N.Y. 1985).

[23] *Id.* at 733, n. 11.

[24] 627 F. Supp. 272 (N.D. Ind. 1985).

Once sufficient state action is established, a mortgagor must be able to demonstrate that his due process rights were infringed. The power of sale procedures allowed in some states may not survive due process scrutiny because notice by publication is permitted and a presale hearing is not normally required. Relying upon several recent United States Supreme Court cases,[25] mortgagors have successfully attacked power of sale statutes as infringing constitutional due process guarantees of the fifth and fourteenth amendments.[26] The court in *Whitney* specifically held that notice by publication will be constitutionally deficient if the veteran's name and address are "reasonably ascertainable."[27] To fully protect rights in their property, veterans should always notify the VA of any changes in address.

Veterans may also attack power of sale foreclosures on the constitutional grounds that the due process clause of the fourteenth amendment requires a hearing before deprivation of

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[25] In *Mennonite Board of Missions v. Adams*, 462 U.S. 791 (1983), the United States Supreme Court held that failure to give a mortgage holder actual notice of a pending tax sale violated procedural due process. *Mennonite* expanded a previous Supreme Court procedural due process decision in *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306 (1950), which held that the notice given must be reasonably calculated to apprise interested parties of the action. Although *Mullane* involved judicial settlement of accounts by a trustee of a common trust fund, several courts have extended the holding to rule that publication notice of a power of sale foreclosure is not constitutionally acceptable. *See, e.g., Ricker v. United States*, 417 F. Supp. 133 (D. Me. 1976); *Roberts v. Cameron-Brown Co.*, 410 F. Supp. 988 (S.D. Ga. 1975). The adequacy of notice of power of sale foreclosures under the due process clause is addressed in Rubin, M. and Carter, E., *Notice of Seizure in Mortgage Foreclosures and Tax Sale Proceedings: The Ramifications of Mennonite*, 48 Lo. L. Rev. 535 (1988), and Scott, R., *Mennonite: What Does it Mean to Alabama Mortgagees After Federal Deposit Insurance Corp. v. Morrison?*, 36 Ala. L. Rev. 969 (1985).

[26] Nelson & Whitman, *supra* note 91, §§ 7.24-7.26, 563-571.

[27] 602 F. Supp. 722 (W.D.N.Y. 1985).

property.[28] A three-judge federal court has held that a hearing prior to foreclosure and sale is constitutionally required.[29]

If the property being foreclosed is owned by a serviceman on active duty, the member may qualify for relief under the provisions of the Soldiers' and Sailors' Civil Relief Act of 1940 (SSCRA).[30] This equitable statute offers remedies if the requirements of military service compromises the members' ability to meet financial obligations or protect legal rights. While none of the statutory provisions removes legal obligations, courts may use the act to suspend or modify a legal obligation.

Most of the provisions of the Act will apply only if the mortgage was entered into prior to entry on active duty. Several provisions of the Act may provide relief before mortgage default. Section 526 of the Act limits interest rates on obligations to 6% annually during the period of military service unless the ability of the member to pay is not "materially affected" by service.

Section 590 of the SSCRA provides that a member may apply to a court within six months of entry on active duty for relief in suspending or modifying pre-service liabilities. Thus, if active duty service will materially affect ability to repay a mortgage, the court may fashion a remedy in addition to reducing mortgage rates. Relief under this provision may be granted only upon request of the service member and is available even if no foreclosure action is brought.

Section 525 of the Act automatically tolls all statutes of limitations that would otherwise run against soldiers while they are on active duty. This section has been construed to extend the time for redemption under state statutory redemption legislation to the period of active duty service.[31]

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[28] Mortgagors making this argument rely on *Sniadich v. Family Finance Corp.*, 395 U.S. 337 (1969) (prejudgment garnishment without a judicial hearing violates due process clause of the fourteenth), and *Fuentes v. Shevin*, 407 U.S. 67 (1972), *rehearing denied*, 409 U.S. 902 (state replevin statutes struck down because no opportunity to be heard prior to repossession from possessor). The most significant hurdle for a mortgagor to succeed on this argument is to establish sufficient state action to apply the fourteenth amendment. If federal action can be found, foreclosure proceedings under state statutes could be found to violate the notice and hearing requirements of the fourteenth amendment.

[29] *Turner v.* Blackburn, 489 F. Supp. 1250 (W.D.N.C. 1975). See also Ricker v. United States, 417 F. Supp. 133 (D. Me. 1976).

30 For a more complete discussion of the SSCRA, see JA 260, The Soldiers' and Sailors' Civil Relief Act Guide.

31 Illinois Nat. Bank v. Gwin, 390 Ill. 345, 61 N.E.2d 249 (1945); Peace v. Bullock, 252 Ala. 155, 40 So.2d 82 (1949). Some courts have held, however, that section 525 does not apply to career servicemen. *Pannell v. Can Co.*, 554 F.2d 216 (C.A. Ga. 1977); *King v. Zagorski*, 207 So. 2d 61 (Fla. App. 1968).

A number of SSCRA provisions also provide relief to mortgagors after foreclosure actions have commenced. One important right afforded mortgagors is the stay provisions of sections 531 and 532, which give courts power to grant stays to soldiers who have defaulted on installment land contracts, mortgages, or deeds of trust. Section 531 addresses stays of land installment contracts and requires judicial action prior to exercising contractual rights to termination, rescission, or repossession. Section 532 of the Act requires a creditor to obtain a court order before foreclosing on a mortgage. Unless the member's ability to comply with the obligation is not "materially affected" by military service, the court must either grant a stay of the proceedings or make some other equitable disposition. Courts have differed on the question of who has the burden of establishing material effect.[32]

Another stay provision, Section 521, allows a court to grant a stay at any stage of a judicial proceeding if the service member's ability to participate as either a plaintiff or defendant is materially affected by military service.[33] A stay of execution may be granted under section 526 of the SSCRA if military service has materially affected the member's ability to comply with the judgment. Finally, section 520 of the SSCRA provides protections to service members against default judgments and includes procedures for setting aside default judgments.[34]

The final source of federal law that might afford some refuge for the financially distressed mortgagor is the federal bankruptcy code.[35] This should be considered a last resort alternative because of its potentially irreversible impact on a debtor's credit standing.

Under federal law, an individual may file for Chapter 7 "straight bankruptcy" to clear all debts including mortgaged property.[36] Filing a bankruptcy petition will operate as a stay on any foreclosure action, even if the foreclosure action was initiated prior to the start of the bankruptcy. Of course, mortgagees and other secured creditors are not barred from enforcing a valid security interest during the bankruptcy. A discharge in bankruptcy does, however, have the favorable

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[32] Compare Meyers v. Schmidt, 181 Misc. 589, 46 N.Y.S.2d 420 (Sup. Ct. 1944) (creditor has the burden to establish that the member's ability to defend is not materially affected by reason of military service) with Queens County Savings Bank v. Thaler, 181 Misc. 229, 44 N.Y.S.2d 4 (Sup. Ct. 1943) (court did not grant relief because the member failed to show that ability to pay was materially affected by military service).

33 50 U.S.C.A. § 525.

34 50 U.S.C.A. § 560. This section requires plaintiffs to file an affidavit indicating whether the defendant is in the military service. If the defendant is on active duty, the court must appoint an attorney to represent the defendant's interest. A service member may also use this section to set aside a default judgment by showing that his or her ability to defend was materially affected by military service and that a meritorious defense existed. The effectiveness of this section is limited by the fact that it will not impair the title acquired by a bona fide purchaser.

[35] Bankruptcy Act, codified at 11 U.S.C. §§ 1 *et. seq.*

[36] 11 U.S.C.A. § 32(f).

aspect of barring deficiency claims that might arise when the property is not sufficient to cover the mortgage debt. The debt will be dischargeable as to the VA only if the VA is a named creditor with actual notice of the bankruptcy.

A veteran may also seek to protect property from mortgagees by filing for a wage-earner's reorganization plan under Chapter 13.[37] Chapter 13 permits debtors to cure defaults and keep possession of the encumbered property. Although a wage-earner plan may not generally modify the rights of holders of mortgages secured by the debtor's principal residence,[38] plans often provide a reasonable time for the debtor to cure a default on a home mortgage. The right to cure a default on a principal residence will be lost, however, if the Chapter 13 request is filed before a foreclosure sale.[39]

V. DEFAULT OF ASSUMED VA-GUARANTEED LOANS.

A disturbingly large percentage of defaults of VA guaranteed loans have occurred on assumed loans. Veterans who have allowed others to assume their VA loans will generally be held liable on the loan unless they have received a release from liability from the VA either at the time of the assumption or subsequent to the sale. Several administrative alternatives may nevertheless be available to a veteran who has not secured a release of liability on an assumed loan. No VA loan entered into since 1988 can be assumed unless the VA consents and notice of this appears on all VA-backed mortgages entered into since that date.

The VA has the discretion to release a veteran from liability on an assumed loan even after default has occurred if the agency would have issued a release of liability had the veteran applied for a release at the time of the assumption. To obtain this retroactive release of liability, the veteran must establish that, at the time of the assumption, the loan was current, a subsequent transferee is legally liable for the full amount of the debt and assumed all contract obligations, and a subsequent transferee was a satisfactory credit risk.

The determination of whether a transferee was a satisfactory credit risk can be made by a retroactive credit report showing the transferee's income, obligations, and credit history at the

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[37] 11 U.S.C.A. §§ 1301-30. To be eligible for a Chapter 13 wage-earner plan, the debtor must have less than a total of $100,000 unsecured debt and $350,000 total secured debt.

38 11 U.S.C. § 1322(b)(2). Several excellent articles have addressed the impact of Chapter 13 on home mortgages. See Zaretsky, Some Limits on Mortgagee's Right in Chapter 13, 50 Brooklyn L. Rev. 433 (1984); Comment, Home Foreclosure Under Chapter 13 of the Bankruptcy Reform Act, 30 UCLA L. Rev. 637 (1983).

39 In re Glenn, 760 F.2d 1428 (6th Cir.), cert. denied, 474 U.S. 849 (1985). The Glenn case is discussed in Note, Bankruptcy Law -- Curing A Mortgage Default -- A Chapter 13 Debtor May Cure Default on Mortgage of His Principal Residence if No Foreclosure Sale Has Taken Place, 63 U. Det. L. Rev. 537 (1986). If there has been no sale when the Chapter 13 petition is filed, the mortgagor is entitled to cure under the bankruptcy plan.

time of the transfer, or by other satisfactory evidence. A transferee will generally be considered a satisfactory credit risk if there was a satisfactory record of timely payments within the first twelve months of transferee's acquisition of the property. If the property was transferred to more than one person, the veteran need only establish that one of them was a satisfactory credit risk. Internal VA guidance and court decisions require that close cases be resolved in favor of releasing the veteran.

It is important to note that even if the VA grants a release of liability the lender may still seek recovery from the veteran for any deficiency unless the veteran-borrower previously obtained a release from the lender.

If the retroactive release of liability procedure is unavailable or if a request has been disapproved, the veteran should contact the transferee and attempt to work out a solution that will protect the veteran's interest. One alternative might be for the parties to work out an agreement to reinstate the loan or sell the property to a third party. Another possibility would be to convince the transferee to deed back the property to the veteran and then pay off the delinquent payments. The parties may also be able to convince the lender and the VA to accept a deed in lieu of foreclosure.

Veterans who have allowed others to assume their loans may also take advantage of the compromise agreement program to minimize financial hardship upon loan termination. The veteran should work out an agreement with the buyer to retake possession of the home, make all overdue payments, and then attempt to sell the home. After receiving an offer to purchase the home for fair market value, the veteran should then request the VA to approve a compromise agreement.

Even if no release of liability is granted, the veteran can still request a waiver of liability. This request should normally accompany the request for release of liability. The request must be filed within one year of actual notice by the veteran of the debt. A waiver may be granted by the VA if collection would be against "equity and good conscience."[40] The agency will evaluate the fault of the veteran, the hardship involved, any unjust enrichment, any detrimental reliance, and other factors. The agency will require detailed financial information and a thorough explanation of the facts and circumstances surrounding the creation of the debt before granting a waiver. Decisions about releases and waivers can both be appealed, as discussed below.

All requests for release or waiver must be made to the VA regional office where the file is located. The local Committee on Waivers and Compromises will issue an initial decision after assisting the veteran in obtaining all relevant facts and records and after hearing the veteran's case. If the Committee issues an unfavorable opinion, the veteran has one year to file a notice of appeal to the Board of Veterans Appeals. After that body issues its final decision, the veteran has 120 days to appeal to the Court of Veterans Appeals and finally can seek review by the Court of Appeals for the Federal Circuit.

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[40] 38 U.S.C.A. § 5302(b)

VI. AVOIDING LIABILITY FOR A DEFICIENCY.

Some states, like Connecticut, have statutes precluding personal liability for the deficiency--the shortfall between the net amount realized on any foreclosure sale and the outstanding balance of the mortgage secured loan (adjusted by fees and costs incident to the default and foreclosure proceedings which may be added to the debt). Most states, however, have no such laws.

Nevertheless, there are some procedures available to avoid or at least minimize the soldier's liability for the deficiency. A veteran may have some administrative alternatives to escape or reduce liability after collection on a deficiency has begun. As discussed, the VA must release a veteran from liability on any defaulted loan if the collection of indebtedness would be "against equity and good conscience." The agency may not grant a waiver if it finds that the veteran is guilty of fraud, misrepresentation, or bad faith in connection with the request for waiver.

Veterans may also consider applying for a VA compromise agreement to minimize the financial hardship associated with repayment of the loan balance. Under this program, the VA may agree to finance a remaining deficiency at a favorable interest rate.

APPENDIX A

Sample Letter of First Response to VA Demand

Date

Legal Assistance Office

VA File #_____

SUBJECT: VA File #____________; Dispute of Debt; Request for Waiver; Request for Hearing; Privacy Act Request

VA Regional Office
<address>

Dear Sir or Madam,

I am writing in response to your letter dated __________ in which you notified me of a $ _________ debt. Despite the date on your letter, I did not receive it until ______________. I do not acknowledge this debt. My correct address is _________________. I notified the VA of this new address on ___________________.

I dispute the existence of this alleged indebtedness.

If, after considering my dispute, you deny the dispute, I request a waiver. It would be against equity and good conscience to demand repayment. I have not acted in bad faith or fraudulently or made any material misrepresentations in creating this debt.

I request a personal appearance before the Committee on Waivers and Compromises at the VA regional office located in [insert VA regional office nearest you] on my dispute and request for waiver of collection.

I request transfer of jurisdiction from the VA regional office nearest the property to the VA regional office closest to my current address in order for me to fairly present my case.

I dispute the amount of the debt. I believe the appraised value of the property was unreasonably low and that the appraisal may have been conducted in violation of VA procedures.

I dispute the assessment of management costs and other fees which accumulated due solely to delay on the part of the VA in selling the property.

I dispute the amount of the debt because I believe the lender did not properly credit my account with interest escrowed.

I dispute the debt because the lender refused to accept the partial payments I offered.

I dispute the amount of the debt because I believe a mistake was made in calculating the amount of the lender's loss the VA should have covered.

I dispute the debt because I believe that the lender failed to follow the VA's instructions when foreclosing on the property.

[Use only in debts following assumptions] Because the VA failed to make any reasonable efforts to notify me that the loan was in default or the home was scheduled for a foreclosure sale, it is in violation of due process under the United States Constitution and under state law to now hold me liable for this debt. Failing to make a reasonable attempt to locate me to provide this notice also violates VA policy.

Because your letter provided no details that explain how you calculated this alleged debt, I am requesting certain materials from you. To adequately prepare for my hearing, I must have these materials at least ten days in advance of the date you schedule my hearing. Making these materials available at the regional office is not sufficient; please mail them to me at the above address. I request a free copy of my records under the Freedom of Information and Privacy Acts:

a. a complete copy of my VA claims file, loan guaranty file, finance file, and overpayment file;

b. Claims Collection Litigation Report;

c. CARS Master Record Printout;

d. photocopies of any and all notices allegedly sent to me that would indicate the date notice was sent and the address to which it was sent;

e. an accounting or financial audit that reveals the exact calculations the VA made to fix the amount of the indebtedness;

f. any rating decisions prepared in this matter;

g. any advisory opinions or legal opinions prepared in this matter;

h. the pertinent portions of any VA circulars, manuals, regulations, or General Counsel opinions or citations to these materials that would explain the basis for fixing this sum of money as a debt or holding me liable for it;

i. copies of any and all notices sent by the original mortgage company to the VA notifying it of default and all papers relating to the foreclosure (to include any appraisals, court complaints, notice of intention to initiate foreclosure);

j. copies of any and all notices sent by the VA to any persons about the default and foreclosure;

k. copies of any and all Reports of Contact between VA employees and any persons about the default and foreclosure;

l. any evaluations, analyses, investigations, or reports on the appraiser who conducted the appraisal of the property;

m. copies of all sales contracts relating to the property at foreclosure and to the present time;

n. copies of all other documents which reveal the costs incurred by the mortgage company and the VA through the foreclosure process and any subsequent handling or reselling.

Until the hearing I have requested has been held, and a written decision has been issued regarding my requests and I have been afforded an opportunity to appeal these determinations, I request that you suspend any debt collection action. I request that you not refer this matter to: (1) any consumer reporting agencies; (2) the Internal Revenue Service; (3) any state or federal agency; (4) any private debt collection agency or attorney; or (5) the District Counsel, Department of Justice, or the General Accounting Office.

Sincerely,

CHAPTER 5

FORMS FOR LEASING REAL ESTATE

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I. DWELLING HOUSE LEASE.

LEASE

THIS LEASE, made this ______ day of ____________, 19 ____, between ____________, hereinafter called LANDLORD, and ____________, hereinafter called TENANT:

WITNESSETH:

That LANDLORD leases to TENANT and TENANT leases from LANDLORD for a term of _____months and _____ days, beginning on the ___________ day of ____________, 19 ___, and terminating on the _____ day of __________, 19 ___, the premises known as ____________________ in the County of ___________, State of ____________, for use as a one-family dwelling only, together with the following personal property located on such premises: ____, at a monthly rental of ___________ DOLLARS ($ ________) per month. Rent for the first ______ days in the amount of __________ DOLLARS ($ _______) shall be payable on or before the _____ day of ___________, 19____. Thereafter, rent shall be payable monthly in advance on or before the _____ day of each month.

The parties further agree:

A. USE OF THE SINGULAR IMPLIES THE PLURAL: Reference to the parties to this lease within this instrument in the singular (such as TENANT and LANDLORD) shall include the plural (such as TENANTS and LANDLORDS) as necessary to effect the intent of the instrument.

B. SECURITY DEPOSIT: TENANT shall, upon execution of this lease, deposit with LANDLORD the sum of ____________ DOLLARS ($ _________) which sum shall be retained by LANDLORD, in a segregated account which LANDLORD may apply only to remedy any default of TENANT in the faithful performance of the terms, conditions, and covenants TENANT has undertaken, including the payment of rent.

Within ____ days following vacation of the premises, LANDLORD shall return to TENANT all of the security deposit not required for payment of rent or to remedy defaults of TENANT. Notwithstanding this _____-day period, LANDLORD agrees to make every reasonable effort to inspect the premises and refund any of the security deposit due TENANT as soon as possible after vacation of the premises.

C. UTILITY CHARGES: Utility charges are to be paid as follows:

Item	*To Be Paid By*
HEAT	
SEWER	

Item	***To Be Paid By***
ELECTRICITY	
GARBAGE	
WATER	
TELEPHONE	
GAS	
OIL	
CABLE TV	

Oil in the tanks shall be measured at the beginning and at the termination of the tenancy, and TENANT shall receive an appropriate debit or credit for the differences in such supplies on the respective dates, utilizing the average market price as of the terminating date.

D. INSPECTION AT COMMENCEMENT OF OCCUPANCY: Prior to execution of this lease, the premises have been inspected by LANDLORD and TENANT and found to be in disrepair or otherwise deficient only as hereafter described. It is agreed that action to be taken with respect to each item of disrepair or deficiency shall be as follows:

Disrepair or Deficiency	***Action To Be Taken***	***Cost To Be Paid By***

Other deficiencies or items of disrepair existing at the beginning of the term which are noted by TENANT after taking occupancy of the premises shall be reported to LANDLORD in writing not more than 10 days after taking occupancy or shall be deemed to be waived by TENANT.

E. INSPECTION AT COMMENCEMENT OF OCCUPANCY (in the alternative to preceding clause): TENANT acknowledges that personal inspection reveals the premises to be in a good and safe condition and TENANT acknowledges entire possession, occupancy, and control of the premises.

F. REPAIRS: TENANT shall promptly repair at TENANT'S expense any damage to the property that may occur by reason of TENANT'S own negligence or the negligence of members of TENANT'S family, invitees, or guests, and all damage caused by pet animals owned by TENANT, TENANT'S family, invitees, or guests, but shall not be responsible for ordinary wear and tear. Required maintenance and other repairs not the result of TENANT'S negligence are to be paid as follows:

Item	***Responsible Party***
Air conditioner	LANDLORD
Basement waterproofing	LANDLORD
Dishwasher	LANDLORD
Disposal	LANDLORD
Dryer	LANDLORD
Electric system, major	LANDLORD
Electric system, minor	TENANT
Exterior, including roof, doors, and windows	LANDLORD
Furnace	LANDLORD
Furnace filters	TENANT
Interior repainting (subject to LANDLORD'S approval)	TENANT
Plumbing, major	LANDLORD
Plumbing, minor	TENANT
Range	LANDLORD
Refrigerator	LANDLORD

Item	*Responsible Party*
Repairs necessitated by fire, smoke, windstorm, flood, earthquake, and other casualty	LANDLORD
Termite and decay damages	LANDLORD
Unenumerated major repairs (including dilapidation that renders premises uninhabitable)	LANDLORD
Unenumerated minor repairs	TENANT
Washing machine	LANDLORD
Water heater	LANDLORD

A repair will be considered major if the cost thereof equals or exceeds $ _____; minor if less than that amount.

The following appliances belonging to LANDLORD may be used by TENANT; however, neither LANDLORD nor TENANT shall be obligated to keep said items in repair except that TENANT shall be liable for negligent damage: ____.

G. PETS: TENANT agrees not to keep, raise or maintain on the premises any pet animals without first obtaining LANDLORD'S written permission. In the event LANDLORD authorizes a pet, TENANT will post a pet-deposit in the amount of $ ____________, refundable to TENANT at the time any security deposit is returned, less amounts occasioned by damages to the premises caused by the pet.

H. TENANT'S PREMATURE VACATION OF THE PREMISES: In the event TENANT vacates the premises or otherwise breaches this LEASE, LANDLORD may demand and TENANT must immediately pay the entire unpaid balance of the rental for the remaining term of the LEASE or such lesser amount determined by LANDLORD. LANDLORD shall attempt to relet the premises and, if successful, shall reduce TENANT'S unpaid rental balance by the amount received by LANDLORD under the reletting agreement except that LANDLORD shall be entitled to recoup the expenses associated with such reletting and repairs necessary to relet. If TENANT should submit a subtenant to assume the remainder of the current lease term, the determination of whether the subtenant submitted by TENANT is suitable shall be at LANDLORD'S sole discretion.

I. MILITARY PROVISIONS.

1. MILITARY LANDLORD: In the event LANDLORD is or hereafter becomes a member of the United States Armed Forces, then LANDLORD may terminate this lease on thirty days' written notice to TENANT in any of the following events:

   a. If LANDLORD receives permanent change-of-station orders to return to the area in which the premises are located.

   b. If LANDLORD is released from active duty.

   c. Other: ______________________________

2. MILITARY TENANT: In the event TENANT is or hereafter becomes a member of the United States Armed Forces, TENANT may terminate the lease on thirty days written notice in any of the following events:

   a. If TENANT receives permanent change-of-station orders to depart from the area in which the premises are located.

   b. If TENANT is released from active duty.

   c. If TENANT has leased the property prior to arrival in the area and TENANT is ordered to a different area before occupying the property.

   d. Other: ______________________________

3. MILITARY NOTICE AND RENT ADJUSTMENT: Notice furnished under the provisions of this paragraph shall include a copy of official orders or a letter signed by the party's commander reflecting the circumstances warranting termination under this paragraph. If LANDLORD terminates the lease under this paragraph, a credit shall be allowed toward the rental otherwise due, and if TENANT terminates the lease under this paragraph, TENANT shall pay an amount in addition to the rental otherwise due. Such adjustment (credit or addition) shall constitute a liquidation of the damages caused by such termination, but shall be in addition to a proration of the rental to the actual termination date and shall not reflect any actual physical damages to the property for which TENANT is otherwise liable under this lease. Said adjustment amounts shall be computed as follows:

   a. If termination occurs before expiration of one-half of the original term, without extension, _____ percent of one month's rent.

   b. If termination occurs on or after the period stated above but before the end of the original term, without extension, _____ percent of one month's rent.

c. If termination occurs on or after the end of the original term of the lease, without extension, there shall be no adjustment of rent under this paragraph.

J. EXTENSION OF TERM: Unless one party gives the other party written notice of termination at least one month prior to expiration of the lease, the lease shall be extended for an additional period of __________. Unless a party provides the other party one month's termination notice at the end of this extension, the lease shall be further extended from year to year thereafter until one party furnishes the other at least one month's notice of intention to terminate.

K. HOLDOVER TENANCY (in the alternative to "EXTENSION OF TERM"): This LEASE will automatically terminate on ___________, 19___, without further action by either LANDLORD or TENANT. In the event TENANT shall remain beyond the expiration of the LEASE and TENANT shall not then have exercised the OPTION TO PURCHASE, TENANT shall pay to LANDLORD an amount equal to twice the monthly installment each month TENANT remains beyond the lease's automatic termination.

L. PRORATED RENTAL PAYMENT (in the alternative to "EXTENSION OF TERM"): If vacation of the premises occurs on a day other than the last day of a normal rental period, the rent due for any resulting partial rental period shall accrue at the daily rate which shall be calculated by dividing the rent due for such period by the number of days in the period. This daily rate shall be multiplied by the number of days TENANT remains on the premises to determine additional rental due.

M. TERMINATION: Upon termination of this LEASE, TENANT shall vacate the premises, remove all personal property belonging to them, and leave all personal property belonging to LANDLORD and leave the premises and such personal property in the condition extant when this LEASE began, normal wear and tear excepted.

N. NOTICES: Unless otherwise provided, any notice provided for by this lease shall begin to run on the date such notice is delivered. If properly sent to the recipient's last known address by prepaid mail, notice shall be construed delivered as of the postmark date or the date of the sender's mail receipt form in the case of certified or registered mail. Notice by LANDLORD or AGENT to TENANT may also be given by posting it on the front door of the premises.

O. TERMINATION BY DEATH OR MISSING STATUS: If LANDLORD, TENANT, or LANDLORD'S or TENANT'S spouse should die or be reported in a missing-in-action status under 37 U.S.C. § 551 during the term of this lease, the spouse of the deceased or missing person or the deceased's executor or administrator may terminate this lease by giving at least one month's written notice. This right of lease termination must be exercised within ____ days of the death or missing status report.

P. TERMINATION DUE TO DEFAULT: After occupancy under this lease has begun, if either party fails to comply timely with any of the terms of this lease and such default continues for 1 month after delivery of a notice to cure the default (except that only a 5-day notice shall be required if the default consists of a failure to pay rent when due), then 1 month after notice (or 5 days in the case of rent), the injured party shall have the option of declaring the lease terminated and shall be entitled to immediately vacate the premises, or take immediate possession thereof as the case might be, without forfeiting whatever further right the injured party may have to damages for breach of the lease. Notice provided for in this paragraph shall begin to run on the date delivered in all cases.

Q. DESTRUCTION OF PREMISES: This lease will terminate if the premises become uninhabitable because of dilapidation, condemnation, fire, or other casualty for a period in excess of 1 month, except where caused in whole or in part by the negligence of TENANT or TENANT'S family, invitee, or guest. Except when caused by the misconduct or negligence of TENANT, TENANT'S family, invitee, or guest, rent shall abate for any period during which the premises are uninhabitable.

R. INSPECTION DURING OCCUPANCY: TENANT will allow LANDLORD or any agent of LANDLORD, duly authorized in writing, to enter upon the premises for purposes of inspection or the posting of "For Sale" signs at reasonable times and, during the last month of this lease, will permit the posting of customary "For Rent" signs and, after reasonable telephone notice, will permit LANDLORD or LANDLORD'S agents to show the premises to prospective TENANTS or purchasers provided TENANT has not exercised the option to purchase.

S. ALTERATIONS AND FIXTURES: TENANT has no authority to make alterations to the premises or to incur any debt or make any charge against LANDLORD or create any lien upon the leased property for any work done or materials furnished without LANDLORD'S express written consent. Any television antenna, cable, or other equipment, or other fixtures installed by TENANT shall be installed at TENANT'S expense, shall be affixed in a manner which will not damage the building, and shall be removed by TENANT at the expiration of the lease. In the event such antenna, other fixture, or other personal property of TENANT is not removed at the expiration of the lease, LANDLORD may treat the same as abandoned and charge TENANT the cost actually paid for removal. Before vacating the premises, TENANT shall cause all picture hooks and similar devices to be removed from all walls and all holes caused by the removal to be filled or repaired.

T. ASSIGNMENT AND MITIGATION OF DAMAGES: TENANT shall not assign or sublet the premises during the term without LANDLORD'S written consent. If, during the term, without cause and without having presented a suitable assignee or subtenant, TENANT vacates the premises, it shall be the LANDLORD'S duty to mitigate damages by making every reasonable effort to rerent the premises for the remainder of the term as agent for TENANT.

U. USE, QUIET ENJOYMENT, AND LOCAL LAWS: TENANT shall keep the streets, alleys, steps, and sidewalks on and adjacent to the premises clear of filth, refuse, debris, and obstructions and shall keep the steps and sidewalks on and adjacent to the premises free from ice and snow. TENANT shall use the premises in compliance with all laws and ordinances applicable thereto and shall not use the premises in a manner that will increase the fire or other liability insurance rate applicable thereto. LANDLORD covenants that TENANT, on paying the rent and complying with the terms of this lease, shall peaceably and quietly have, hold, and enjoy the premises for the term of the lease.

V. TIME OF THE ESSENCE: Time is of the essence in the matter of possession of the premises, and the failure of either party to permit possession by the party entitled thereto shall entitle the offended party to any damages provided by law. If initial possession on the date provided is denied TENANT because of possession by LANDLORD or third persons, failure of LANDLORD to complete initial repairs, or other fault of LANDLORD, TENANT may, upon being so denied such possession for a period in excess of 24 hours, terminate this lease by notifying LANDLORD and, if so terminated, TENANT shall be entitled to a return of money paid under the lease and any damages provided by law.

W. TAXES: LANDLORD shall pay any and all property taxes upon the premises until the expiration of this LEASE or termination thereof by the sale to TENANT of the premises described herein pursuant to the OPTION TO PURCHASE provision, in which event the taxes shall be prorated to the date of purchase with appropriate adjustment in the purchase price.

X. OFFER: This document, when signed by one of the parties only, constitutes an offer which may be revoked at any time prior to delivery, to the first party signing, of a fully executed original. If such delivery is made by mail, time of delivery shall be the postmark date.

Y. AGENTS: If LANDLORD retains an agent who is an attorney or licensed real estate agent, any authority vested in LANDLORD under the terms of this lease may be exercised by LANDLORD'S agent and all notices to be furnished LANDLORD may be furnished to LANDLORD'S agent; otherwise, such agent must have written authority from LANDLORD, a signed copy thereof to be furnished TENANT, to exercise such authority or receive such notice.

Z. LAWSUITS: If either party successfully enforces this LEASE in court, or successfully asserts or defends the existence or validity of this agreement, the successful party shall be awarded court costs and reasonable attorneys fees to be paid by the other.

IN WITNESS WHEREOF, the parties have set their hands and seals to duplicate copies of this lease, each of which shall constitute an original.

________________________(SEAL)
LANDLORD

________________________(SEAL)
TENANT

II. ALTERNATE DWELLING HOUSE LEASE.

THIS LEASE, made this ____ day of _________, 19___, between LANDLORD hereinafter called the Landlord, and TENANT, hereinafter called the Tenant:

WITNESSETH: That the Landlord leases to the Tenant and the Tenant leases from the Landlord for a term of ____months, beginning on the _____ day of ______________, 19___, and terminating on the ______ day of ____________, 19___, the premises known as, ____ in the County of ________________, State of ______________, for use as a one-family dwelling only, at a monthly rental of ________________________________ DOLLARS ($________) per month. Rent for the first ______ days in the amount of ______________________________ DOLLARS ($_______) shall be payable by the ______ day of ____________, 19__. Thereafter rent shall be payable monthly in advance on or before the _________ day of each month.

The parties further agree:

A. UTILITY CHARGES: Utility charges are to be paid as follows:

Item	***To Be Paid By***	***Item***	***To Be Paid By***
HEAT	Tenant	SEWER	Tenant
ELECTRICITY	Tenant	GARBAGE	Tenant
WATER	Tenant	TELEPHONE	Tenant

B. INSPECTION AT COMMENCEMENT OF OCCUPANCY: Prior to execution of this lease the premises have been inspected by the Landlord and Tenant and found to be in disrepair or otherwise deficient as hereafter described. It is agreed that action to be taken with respect to each item of disrepair or deficiency shall be as follows:

Disrepair or Deficiency	***Action To Be Taken***	***Cost Paid By***

Other deficiencies or items of disrepair existing at the beginning of the term which are noted by the Tenant after taking occupancy of the premises shall be reported to the Landlord in writing not more than 10 days after taking occupancy or shall be deemed to be waived by the Tenant.

Page ____ of _____

_______ _______
(Initials)

C. REPAIRS: The Tenant shall promptly repair at his own expense any damage to the property which may occur by reason of his own negligence or the negligence of members of his family, invitees, or guests and all damage caused by pet animals owned by the Tenant, members of his family, invitees, or guests but shall not be responsible for ordinary wear and tear. Required maintenance and other repairs, not the result of the Tenant's negligence, are to be paid as follows: (a repair will be considered major if the cost thereof equals or exceeds $____; minor if less than that amount.)

1. furnace filters ....Tenant
2. minor plumbing...Tenant
3. electric system (minor) ....Tenant
4. other unenumerated minor repairs ....Tenant
5. repairs necessitated by fire, smoke, windstorm, flood, earthquake, and other casualty ....Landlord
6. air conditioner ....Landlord
7. water heater..Landlord
8. major plumbing...Landlord
9. electric system (major)..Landlord
10. other unenumerated major repairs, including damage which renders premises uninhabitable...Landlord
11. disposal ....Landlord
12. refrigerator ....Landlord
13. range..Landlord
14. termite and decay ....Landlord
15. furnace and/or heater...Landlord
16. exterior, including roof damage, doors, and windows...........Landlord
17. painting, exterior and interior (if required) ....Landlord
18. maintenance of grounds:
    a. grass cutting and orderly grooming ....Tenant
    b. seeding and chemical treatments (if required)...........Landlord
    c. removal of dead, diseased, or damaged trees and/or shrubbery ....Landlord

Page ____ of _____

_______ _______
(Initials)

D. MILITARY TENANT: Both the Tenant and the Landlord are members of the United States Army. Either party may terminate the lease on 30 days' written notice to the other party in any of the following events:

1. If the Tenant or Landlord receives permanent change-of-station orders to depart from the area where the premises are located.
2. If the Tenant or Landlord is released from active duty.
3. If the Tenant or Landlord has leased the property prior to arrival in the area and his orders are changed to a different area prior to occupancy of the property.

E. EXTENSION OF TERM: Unless at least one month's notice in writing be given by one of the parties prior to expiration of the lease of an intention to terminate the lease at end of the term, the lease shall be extended for an additional period of 90 days. Unless such one month's notice of intention to terminate at the end of such extension be given by one of the parties, the lease shall be further extended from month to month thereafter until either party furnish the other at least one month's notice of intention to terminate.

F. LIABILITY INSURANCE: Each party shall insure against liability to other party to the extent each deems desirable. If the Tenant does not have a fire liability policy in effect at the time of a fire loss for which the Tenant, a member of his family, his invitees, or guests is liable, then providing the Landlord's fire loss insurance is not voided by such a waiver, the Landlord waives to the extent of the coverage of his own fire loss policy all claims against the Tenant, his family, his invitees, and guests for fire loss caused by the negligence of any of them, and in such event the Landlord's fire loss policy shall be deemed to have been issued for the mutual benefit of the Landlord and Tenant. If there is a Tenant's fire liability policy in effect but a fire loss exceeds the limits of the policy, the waiver, provided the Landlord's fire insurance coverage is adequate to cover the loss and not voided by such waiver, shall apply only to the liability which is in excess of the Tenant's coverage.

G. NOTICES: Unless otherwise provided, any notice provided for by this lease shall begin to run on the date such notice is delivered. If vacation of the premises pursuant to such notice occurs on a day other than the last day of a normal rental period, the rent due for any resulting partial rental period shall accrue at the daily rate which shall be calculated by dividing the monthly rate by the number of days in the month in which the premises are vacated. If properly sent to the recipient's last known place of address, by prepaid mail, notice shall be construed as delivered as of the postmark date of sender's mail receipt form in the case of certified or registered mail.

Page ____ of _____ ______ ______

(Initials)

H. TERMINATION BY DEATH OR MISSING STATUS: If the Landlord or Tenant, husband or wife, should die or be reported in a missing status under 37 U.S. Code, Section 551, during the term of this lease, the spouse of the deceased or missing person or the Executor or Administrator of the deceased may terminate this lease by giving at least one month's written notice.

I. TERMINATION BECAUSE OF DEFAULT: After occupancy under this lease begins, if either party fails to comply timely with any of terms of this lease and such default continues for 1 month after delivery of a notice to cure the default, (except that only 5 days notice shall be required if the default consists of a failure to pay rent when due), then 1 month after notice (or 5 days in the case of rent), the injured party shall have the option of declaring the lease terminated and shall be entitled to immediately vacate the premises, or have immediate possession thereof as the case might be, without forfeiting whatever further right the injured party may have to damages for breach of the lease. Notice provided for in this paragraph begins to run on the date delivered in all cases.

J. DESTRUCTION OF PREMISES: This lease will terminate if the premises become uninhabitable because of dilapidation, condemnation, fire, or other casualty for a period in excess of one month.

K. INSPECTION DURING OCCUPANCY: Tenant will allow Landlord or any agent of the Landlord, duly authorized in writing, to enter upon the premises for purposes of inspection or the posting of "For Sale" signs at reasonable times and during the last month of this lease will permit the posting of customary "For Rent" signs and, after reasonable telephone notice, will permit the Landlord or his agents to show the premises to prospective Tenants or purchasers.

L. ALTERATIONS OR FIXTURES: The Tenant has no authority to make any alterations to the premises or to incur any debt or make any charge against the Landlord or create any lien upon the leased property for any work done or materials furnished without the express consent of the Landlord in writing. Any television antenna or other fixtures installed by the Tenant shall be at his own expense, shall be affixed in a manner which will not damage the building, and shall be removed by the Tenant at the expiration of the lease. In the event such antenna, other fixture, or other personal property of the Tenant is not removed at the expiration of the lease, the Landlord may treat the same as abandoned and charge the Tenant the cost actually paid for the removal.

M. ASSIGNMENT AND MITIGATION OF DAMAGES: The Tenant shall not assign or sublet the premises during the term without the written consent of the Landlord. If during the term, without cause and without having presented a suitable assignee or subtenant, the Tenant vacates the premises, it shall be the duty of the Landlord to mitigate damages by making every reasonable effort to rerent the premises for the remainder of the term as agent for the Tenant.

Page ____ of _____

_______ _______
(Initials)

N. USE, QUIET ENJOYMENT, AND LOCAL LAWS: The Tenant shall keep the streets and alleys adjacent to the premises clear of filth, refuse, and obstructions; the steps and sidewalks free from ice and snow; and will use the premises in compliance with all laws and ordinances applicable thereto and in a manner which will not increase the fire insurance rate applicable thereto. The Landlord covenants that the Tenant, on paying the rent and complying with the terms of this lease, shall peaceably and quietly have, hold, and enjoy the premises for the term of the lease.

O. TIME OF THE ESSENCE: Time is of the essence in the matter of possession of the premises, and the failure of either party to permit possession by the party entitled thereto shall entitle the offended party to any damages provided by the law. If initial possession on the date provided is denied the Tenant because of possession by the Landlord or third persons, failure of the Landlord to complete initial repairs or other fault of the Landlord, the Tenant may, upon being so denied such possession for a period in excess of 24 hours, terminate this lease by notice to the Landlord and, if so terminated, the Tenant shall be entitled to a return of money paid under the lease and damages as provided for in this clause.

P. OFFER: This document, when signed by one of the parties only, constitutes an offer which may be revoked at any time prior to delivery, to the first party signing, of a fully executed original. If such delivery is made by mail, time of delivery shall be the postmark date.

Q. AGENTS: If the Landlord retains an agent, who is an attorney or licensed real estate agent, any authority vested the Landlord under the terms of this lease may be exercised by the Landlord's agent and all notices to be furnished the Landlord may be furnished to the Landlord's agent; otherwise, such agent must have authority in writing from the Landlord, a signed copy thereof to be furnished the Tenant, to exercise such authority or receive such notice.

IN WITNESS WHEREOF, the parties have set their hands and seals to duplicate copies of this lease, each of which shall constitute an original.

LANDLORD: ____

TENANT: ____

Page ____ of _____

_______ _______
(Initials)

III. OPTIONAL LEASE PROVISIONS.

A. OPTION TO PURCHASE: LANDLORD hereby gives and grants unto TENANT the option to purchase the leased premises on or before _____________, 19___, at 12 noon, time being of the essence of such option, for and at a purchase price of ______ ($ _________). In consideration of this OPTION TO PURCHASE, TENANT agrees to pay LANDLORD a nonrefundable OPTION FEE of _________ ($ _________) payable in ___ installments of ___________ ($ _________) each on: (specify the due dates for the option fee payments if paid in installments) together with the monthly installment then due for rental of the designated month. If the option is earlier exercised, then the balance of the OPTION FEE shall become due and payable at the time of such exercise. This OPTION FEE, together with ________ DOLLARS ($ _________) of each of the monthly installments of the rent actually paid will be credited toward the purchase price of the premises, but only if the OPTION TO PURCHASE is exercised in accordance with the terms of this provision. Such monies are not refundable if TENANT does not exercise this OPTION TO PURCHASE. This OPTION TO PURCHASE is personal to TENANT and may not be assigned, transferred, or otherwise delivered unto any other person. In the event TENANT complies with the terms of the LEASE and exercises the OPTION TO PURCHASE at the end of the term of the LEASE, then the purchase price shall be ____________ DOLLARS ($ ________), being the original purchase price less the aforesaid credits. If the option is exercised earlier, then the credit shall be based upon the payments accrued to the date of purchase. This LEASE shall terminate upon the completion of the purchase, but shall remain in effect until title passes to TENANT by delivery of a deed by LANDLORD.

B. SECURITY DEPOSIT ARBITRATION: In the event of a dispute between LANDLORD and TENANT concerning the security deposit, the parties agree immediately to submit the dispute for final determination to three arbitrators who shall, at the request of either party, be appointed: one by each party and the third by the two arbitrators so designated. The fee of the arbitrators shall be paid as determined by the arbitrators, but in any event not less than 1/3 by the party in whose favor the dispute is resolved and not more than 2/3 by the party against whom such dispute is resolved.

C. LIABILITY INSURANCE: Each party shall insure against liability to the other party to the extent each deems desirable.

1. All personal property located in or upon the leased premises shall be at the risk of TENANT or other owner thereof; and LANDLORD shall not be liable for any damage thereto or loss thereof arising from any criminal act, condition of the property or the premises, or act of negligence, carelessness, or improper failure to act, or improper conduct of any person whomsoever unless LANDLORD knows or has reason to know of a latent condition that threatens the safety or security of the property and fails to inform TENANT of the condition and the condition contributes materially to the property's loss or damage.

2. If TENANT maintains fire insurance at the time of loss due to fire for which TENANT, TENANT'S family, invitees, or guests are liable, TENANT'S insurance shall cover such loss. If both LANDLORD and TENANT maintain fire insurance but fire loss exceeds the limits of TENANT'S policy and LANDLORD'S fire insurance coverage is adequate to cover the loss and not voided by TENANT'S coverage, LANDLORD'S insurance shall cover only the loss in excess of that covered by TENANT'S insurance. If TENANT does not have fire insurance at the time of a fire loss for which TENANT, TENANT'S family, invitees, or guests are liable, LANDLORD waives, to the extent of LANDLORD'S fire insurance coverage, all claims against TENANT, TENANT'S family, invitees, and guests for such fire loss and in such event LANDLORD'S fire loss policy shall be deemed to have been issued for the mutual benefit of LANDLORD and TENANT.

D. UTILITY CHARGES: All charges for utilities, including but not limited to charges for heating, electricity, water, sewer, garbage, and telephone, shall be paid by TENANT.

IV. MANAGEMENT OF PROPERTY CONTRACT.

CONTRACT

This agreement, made and concluded at ________ this ___ day of ________, 19 __, by and between ______________, hereinafter called OWNER, and ____________, hereinafter called AGENT, witnesseth:

OWNER hereby employs AGENT to take charge and management of the following property or properties that belong to OWNER:

____.

AGENT is hereby authorized:

A. To negotiate, execute, acknowledge, and deliver leases of said property or properties, or any portion or portions thereof, for a term not exceeding __________, for such rents, and containing such covenants, conditions, and provisions as AGENT may deem wise:

B. To let and lease the house or other said property from year to year, or month to month, with a written lease, for such rent as AGENT may deem wise, but not less than __________ Dollars per month;

C. To collect, receive, and receipt for all rents and moneys payable by TENANT of said property or properties:

D. To do and perform all other acts or things which AGENT may deem necessary or advisable in the proper management of said property of properties; however, AGENT will specifically be responsible for the following enumerated acts or responsibilities:

____.

E. AGENT accepts said employment and hereby additionally promises and agrees to and with OWNER as follows:

   1. To faithfully perform his or her duties in the care and management of said properties to the best of AGENT's ability and skill and to the satisfaction of OWNER;

   2. To remit to OWNER a report and all moneys received by AGENT during the preceding calendar month, after deducting the disbursement made by AGENT during such month for repairs and other proper expenses as herein authorized and after deducting the compensation of AGENT for such preceding calendar month.

3. It is mutually agreed by between the parties hereto as follows:

   a. The compensation of agent for all services in managing and caring for said property shall be a sum equal to ____ percent of the gross amount of rents and moneys paid by TENANT of said property during the continuance of this agreement, and the same may be deducted by AGENT for said monthly remittance;

   b. Said employment shall continue for a period of ____ months/years from the date hereof and thereafter until terminated by either party hereto by providing ____ days' notice in writing to the other or by sale of said property by OWNER and providing ____ days' notice in writing to AGENT.

Executed the day and year first above written.

____________________ (AGENT) ____________________ (OWNER)

STATE OF __________________________

COUNTY OF __________________________

Subscribed and sworn to before me this ____ day of________, 19___.

________________ (NOTARY PUBLIC)

V. INVENTORY OF LANDLORD'S PERSONAL PROPERTY AT PREMISES.

INVENTORY OF LANDLORD'S PERSONAL PROPERTY TO BE LEFT AT PREMISES FOR PERSONAL USE BY TENANT DURING LEASE

ITEM	***CONDITION***

VI. CHECKLIST FOR CONDITION OF PREMISES.

CHECKLIST

The following is a summary of the condition of the premises located at _____________ on the dates indicated below.

AREA	***CONDITION ON ARRIVAL***	***CONDITION ON DEPARTURE***
LIVING ROOM		
Floors & Floor Coverings		
Drapes		
Walls & Ceilings		
Furniture, if any		
Light Fixtures		
Windows, Screens, & Doors		
Other		
KITCHEN		
Floor Covering		
Stove & Refrigerator Windows, Screens, & Doors Light Fixtures		
Sink & Plumbing Cupboards		
Other		

DINING ROOM		
Floors & Floor Coverings Drapes		
Walls & Ceilings		
Furniture, if any		
Light Fixtures		
Windows, Screens & Doors		
Other		
BATHROOMS		
Toilets		
Sinks		
Showers		
Floors, Walls & Ceilings		
Light Fixtures		
Windows, Screens & Doors		
Other		
BEDROOMS		
Floors & Floor Coverings		
Walls & Ceilings		
Furniture, if any		
Windows, Screens, & Doors		
Light Fixtures		
Other		

OTHER AREAS		
Floors & Floor Coverings		
Windows, Screens & Doors		
Walls & Ceilings		
Furnace		
Air Conditioning, if any		
Lawn Ground Covering		
Patio Terrace Deck, etc.		
Other		

Checklist filled out upon moving in on ____________, 19 ____, and approved by ______________ (LANDLORD or AGENT) and ______________ (TENANT).

Checklist filled out upon moving out on ___________, 19____, and approved by ____________ (LANDLORD or AGENT) and _______________ (TENANT).

CHAPTER 6

SECURITY DEPOSITS

I. INTRODUCTION.

Over the last several decades, there has been what some term a "revolution" in landlord-tenant law, with many states stepping in statutorily to modify the respective rights of the parties in landlord-tenant agreements. Most of these changes have operated to the benefit of tenants, with the statutes providing protections against various abuses by landlords. Security deposit legislation is not only an area where these protections may exist, but an area where military clients have a particular interest. Many of our most vulnerable service members will be renters. Proper legal assistance advice with regard to a client's liabilities and rights concerning his security deposit can provide true value to our soldiers, since protecting these legal rights can translate directly into monetary savings.

II. STATE LAWS IN GENERAL.

The problem with this area is that the 50 states have taken their own individual approach, since there is no federal law mandating how security deposits shall be handled. Fifteen states have substantially adopted the Uniform Residential Landlord-Tenant Act (URLTA), a model code approved by the National Conference of Commissioners on Uniform State Laws in 1972.[1] This Act extends the concept that leases are contractual in nature, viewing leases as bilateral contracts rendering performance of many of its obligations interdependent. A few states have not enacted any legislation in the area. The remaining states and the District of Columbia have enacted statutes varying greatly in their approach to the respective rights and obligations of landlords and tenants with regard to the security deposit.

To establish a foundation upon which comparisons may be made and to facilitate analysis, however, attorneys should consider eight predominant factors found in security deposit statutes. Though not all eight factors are found in each state's statutes, these eight factors identify the major areas of concern when analyzing a security deposit case. The eight factors are:

1. *Prerequisites*. Prerequisites are required in some states before the statute applies. For example, some states require that a landlord rent a certain number of units before the landlord is required to pay interest on security deposits.

[1] A table of these states and a basic statutory reference to begin research is at the end of this chapter. The uniform act is available on WESTLAW in the ULA database. Note, however, that the states which have adopted the uniform act tend to modify certain provisions. The notes within the uniform act normally indicate that a particular state's act is "a substantial adoption of the major provisions of the Uniform Act, but contains numerous variations, omissions and additional matter which cannot be clearly indicated by statutory notes." To properly advise clients, the state code must be used.

2. *The security deposit.* Always identify the particular state's definition (if any), the maximum amount allowed, and whether the landlord may or must place the deposit in escrow, put it in a state bank, commingle it with other funds, or pay interest on it.
3. *Landlord requirements.* Many states limit the circumstances under which the landlord may retain a portion of the security deposit. Many also define certain requirements that the landlord must meet if he intends to retain any or all of the deposit.
4. *Time requirements.* Many states place time limits on the landlord to inspect the property before a tenant leaves; to notify the tenant of damages and the landlord's intent to retain the security deposit; and to return the security deposit (or its remainder). Also, some states require a tenant to respond within a certain time.
5. *Notification procedure.* Often, these statutes will define how the landlord is to notify the tenant (and vice versa).
6. *Transferee liability.* Once property changes hands, who is liable to the tenant for return of the security deposit? Though it is almost universal that the obligation transfers with the interest, some states keep the prior landlord jointly liable.
7. *Penalties.* Penalties may be assessed against landlords who wrongfully fail to return security deposits. If your state mandates penalties, they can provide excellent leverage for you to use in your negotiations.
8. *Tenant requirements.* Some states require action by the tenant once the landlord has notified the tenant of an intent to retain the security deposit..

Legal assistance practitioners cannot properly advise in this area without detailed knowledge of their state's landlord-tenant laws. Providing current and accurate detail of these laws for all 50 states is outside the scope of this publication. Consequently, the state-by-state summaries of security deposit legislation that were formerly part of this publication are discontinued. Practitioners should consult the most recent version of the *Martindale-Hubbell Law Digest*[2] under the heading "Landlord and Tenant" for their particular state to start their research. Attorneys must then familiarize themselves with the actual statutory language to properly advise their clients in this critical area.

[2] This publication is available on LEXIS-NEXIS, MARHUB Library, MHDIG file.

Jurisdictions Substantially Adopting URLTA			
Jurisdiction	***Laws***	***Effective Date***	***Statutory Citation***
Alaska	1974	3-19-1974	ALASKA STAT. §§ 34.03.010 to 34.03.380.
Arizona	1973	8-8-1973	ARIZ. REV. STAT. §§ 33-1301 to 33-1381.
Florida	1973	6-25-1973	FLA. STAT. ANN. §§ 83.40 to 83-330 (West)
Hawaii	1972		HAW. REV. STAT. §§ 521-1 to 521-78
Iowa	1978	1-1-1979	IOWA CODE ANN. §§ 562A.1 to 562A.37. (West)
Kansas	1975	7-1-1975	KAN. STAT. ANN. §§ 58-2540 to 58-2573.
Kentucky	1974	8-1-1974	KY. REV. STAT. ANN. §§ 383.500 to 383.715.
Montana	1977	7-1-1977	MONT. CODE ANN. §§ 70-24-101 to 70-24-442.
Nebraska	1974	7-1-1975	NEB. REV. STAT. §§ 76-1401 to 76-1449.
New Mexico	1975	7-1-1975	N.M. STAT. ANN. §§ 47-8-1 to 47-8-52. (Michie)
Oregon	1973	10-5-1973	OR. REV. STAT. §§ 90.100 to 90.940.
Rhode Island	1986	1-1-1987	R.I. GEN. LAWS 1956, §§ 34-18-1 to 34-18-57.
South Carolina	1986	3-10-1986	S.C. CODE ANN. §§ 27-40-10 to 27-40-940 (Law Co-op.).
Tennessee	1975	7-1-1975	TENN. CODE ANN. §§ 66-28-101 - 66-28-516.
Virginia	1974	7-1-1974	VA. CODE ANN. §§ 55-248.2 to 55-248.40.

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CHAPTER 7

GLOSSARY OF REAL ESTATE TERMS

Abstract (Of Title)

A summary of the public records relating to the title to a particular piece of land. An attorney or title insurance company reviews an abstract of title to determine whether there are any title defects which must be cleared before a buyer can purchase clear, marketable, and insurable title.

Acceleration Clause

A provision in a mortgage that may require the unpaid balance of the mortgage loan to become due immediately if the regular mortgage payments are not made, or if other terms of the mortgage are not met.

Amortization

The repayment of a loan through monthly level payments of principal and interest so that the loan is fully repaid upon the final monthly payment.

Appraisal

An evaluation of a piece of property to determine its value; that is, what it would sell for in the marketplace.

Assessment

The value placed on property by a local government for purposes of taxation. It may also refer to a special tax due for a special purpose, such as a sewer assessment.

Binder

A preliminary agreement, secured by the payment of earnest money between a buyer and seller that is usually followed by a more detailed agreement. A binder secures the right to purchase real estate upon agreed terms for a limited period of time. If the buyer changes his mind or is unable to purchase, the earnest money is forfeited unless the binder expressly provides that it is to be refunded.

Certificate of Title

A certificate issued by a title company or a written opinion rendered by an attorney that the seller has good marketable and insurable title to the property. A certificate of title offers no protection against any hidden defects in the title which an examination of the records could not reveal. The issuer of a certificate of title is liable only for damages due to negligence.

Cloud (On Title)

An outstanding claim or encumbrance which adversely affects the marketability of title.

Closing

The day on which the formalities of a real estate sale are concluded. The title is transferred from the seller to the buyer, and payment is made in accordance with the terms of the sales contract.

Closing Costs

The various expenses which buyers and sellers normally incur to complete a transaction in the transfer of ownership of real estate. These costs are in addition to the purchase price of the property and are paid at the closing.

Commission

Money paid to a real estate agency or broker by the seller as payment for finding a buyer and completing a sale. Usually, it is a percentage of the sales price and is spelled out in the listing agreement and sales contract.

Community Property

In some states, principally in the West, a form of ownership under which property acquired during a marriage is presumed to be owned jointly unless acquired as separate property of either spouse.

Condominium

Individual ownership of a dwelling unit and an undivided interest in the common areas and facilities which serve the multi-unit project.

Conventional Loan

A mortgage loan which is not insured by the FHA or guaranteed by the VA.

Cooperative

An apartment building or group of housing units owned by all the residents (usually through a corporation) and run by an elected board of directors for the benefit of the residents. The resident lives in his unit, but does not own it. Instead, he owns a share of stock in the corporation with a right to occupy his unit.

Deed

A formal written instrument by which title to real property is transferred from one owner to another. See also deed of trust, general warranty deed, quitclaim deed, and special warranty deed.

Deed of Trust

In some states, a document used instead of a mortgage. It transfers title of the property to a third party (the trustee) who holds the title until the debt or mortgage loan is paid off, at which time the title (ownership) passes to the borrower. If the borrower defaults (e.g., fails to make mortgage payments), the trustee may sell the property at a public sale to pay off the loan.

Documentary Stamps

In some states, a tax, in the form of stamps, required on deeds and mortgages when real estate title passes from one owner to another. The amount required differs from one state to another.

Down Payment

The money to be paid by the purchaser toward the purchase price which is not paid through loan funds. It is the difference between the purchase price and the amount of the mortgage loan.

Earnest Money

The deposit money given by the purchaser to the seller or a third party upon the signing of the sales contract. The deposit is subsequently applied to the down payment at closing.

Easement

A right-of-way granted to a person or company authorizing access to or over the owner's land. An electric utility obtaining a right-of-way across private property is a common example.

Encroachment

An obstruction, building, or part of a building that intrudes beyond a legal boundary onto neighboring private or public land, or a building extending beyond the building line.

Encumbrance

A third-party or extraneous interest in land that affects a clear title. It can take numerous forms, such as zoning ordinances, easement rights, mortgages, liens, charges, a pending legal action, unpaid taxes, or restrictive covenants.

Equity

The value of a homeowner's unencumbered interest in real estate. Equity is computed by subtracting from the property's fair market value the total of the unpaid mortgage balance and any outstanding liens or other debts against the property.

Escrow

Money or documents held by a third party until the occurrence of a specified event, after which the money or documents are released in accordance with agreed instructions.

Escrow Payment

That part of a borrower's monthly payment held by the lender to pay for taxes, hazard insurance, mortgage insurance, and other items until these obligations are satisfied.

Foreclosure

The legal process by which a lender enforces payment of a loan (under a mortgage or deed of trust) by taking the property from the owner (mortgagor) and selling it to pay off the debt.

General Warranty Deed

A deed which conveys not only all the grantor's interest in the title to the property to the grantee, but also warrants that if the title is defective or has a "cloud" on it (such as mortgage claims, tax liens, title claims, judgments, or mechanic's liens against it) the grantee may hold the grantor liable.

Grantee

The person to whom real estate is conveyed by deed.

Grantor

The person who conveys real estate by deed.

Hazard Insurance

Insurance which protects against damage caused to property by fire, windstorm, or other common hazard. Required by many lenders to be carried in an amount at least equal to the mortgage.

Joint Tenancy

An equal, undivided ownership of property by two or more persons. Should one of the owners die, his share of the ownership would pass to the surviving owners (right of survivorship).

Lien

A legal claim which someone has on the property of another, as security for a debt or charge; if a lien is not removed (if the debt is not paid), the property may be sold through legal process to pay off the lien.

Loan Commitment

An agreement from a lender to make a loan to a borrower to enable him to purchase a home.

Marketable Title

A title that is free and clear of objectionable liens, clouds, or other title defects. A title which enables an owner to sell his property freely to others and which others will accept without objection.

Mortgage

A lien against real property given by the buyer to the lender as security for money borrowed.

Mortgagee

The lender who makes a mortgage loan.

Mortgagor

The person borrowing money for a mortgage loan.

Plat

A map or chart of a lot, subdivision, or community drawn by a surveyor showing boundary lines, building, improvements on the land, and easements.

Point(s)

An amount equal to 1% of the principal amount of a loan. Points are a one-time charge collected by the lender at closing to increase the return on the loan.

Prepaid Items

An advance payment, at the time of closing, for taxes, hazard insurance, and mortgage insurance which is held in an escrow account by the lender.

Quitclaim Deed

A deed which transfers whatever interests the grantor of the deed may have in the particular parcel of land. A quitclaim deed is often given to clear the title when the grantor's interest in a property is questionable. By accepting such a deed, the buyer assumes all the risks. Such a deed makes no warranties as to the title, but simply transfers to the buyer whatever interest the grantor has.

Refinancing

The process of the same borrower or mortgagor paying off one loan with the proceeds from another loan.

Restrictive Covenants

Private restrictions limiting the use of real property. Restrictive covenants are created by deed and may "run with the land," binding all subsequent purchasers of the land, or may be "personal" and binding only between the original seller and buyer. The determination whether a covenant runs with the land or is personal is governed by the language of the covenant, the intent of the parties, and the law in the state where the land is situated. Restrictive covenants that run with the land are encumbrances and may affect the value and marketability of title. Restrictive covenants may limit the density of buildings per acre, regulate size, style, or price range of buildings to be erected, or prevent particular businesses from operating in a given area.

Special Assessments

A special tax imposed on property, individual lots, or all property in the immediate area for road construction, sidewalks, sewers, street lights, etc.

Special Lien

A lien that binds a specific piece of property, unlike a general lien which is levied against all of a person's assets. It creates a right to retain something of value belonging to another person as compensation for labor, material, or money expended in that person's behalf. In some localities, it is called "particular" lien or "specific" lien. (See Lien).

Special Warranty Deed

A deed in which the grantor conveys title to the grantee and agrees to protect the grantee against title defects or claims asserted by the grantor and those persons whose right to assert a claim against the title arose during the period the grantor held title to the property. In a special warranty deed, the grantor guarantees to the grantee that he has done nothing during the time he held title to the property which has impaired, or which might impair in the future, the grantee's title.

Survey

A map or plat made by a licensed surveyor showing the results of measuring the land with its elevations, improvements, boundaries, and its relationship to surrounding tracts of land. A survey is often required by the lender to assure that a building is actually sited on the land according to its legal description.

Tenancy by the Entirety

The joint ownership of property by a husband and wife. If either one dies, his or her share of ownership goes to the survivor.

Tenancy in Common

When property is owned by two or more persons without right of survivorship. Each person has an undivided, but not necessarily equal, ownership interest in the property.

Title

The rights of ownership in a particular property, and the document which proves that ownership (commonly a deed).

Title Insurance

An insurance policy issued by a title company that protects lenders or homeowners against loss of their interest in property due to legal defects in title. Title insurance may be issued to either the mortgagor, as an "owner's title policy," or to the mortgagee, as a "mortgagee's title policy."

Title Search or Examination

A search or examination of the title records, generally at the local courthouse, to make sure the buyer is purchasing a house from the legal owner and there are no liens, overdue special assessments, or other claims outstanding, or restrictive covenants filed in the record, which would adversely affect the marketability or value of title.

Zoning Ordinances

The laws of a local government establishing building codes and setting forth regulations for property land usage.